Explanatory Notes Relating to Remaining Budget 2006 Income Tax Measures, Dividend Taxation and Canadian Vintners and Brewers

Published by
The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

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Canada

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Preface

These explanatory notes are provided to assist in understanding proposed amendments to the *Income Tax Act*.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

These notes are intended for information purposes and should not be construed as an official interpretation of the provisions they describe.

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Part 1

Clause 2

Apprentice mechanic's tool costs

ITA
8(1)(*r*)

Paragraph 8(1)(*r*) of the Act allows an eligible apprentice mechanic to deduct the cost of certain extraordinary expenditures incurred by the apprentice in respect of the cost of eligible tools.

In general terms, extraordinary expenditures are the costs incurred by an apprentice in a taxation year in respect of eligible tools acquired in the taxation year in excess of a threshold. This threshold is provided for in the description of B in the formula in subparagraph 8(1)(*r*)(ii) as the lesser of two amounts. The first is the cost of the eligible tools. The second is the greater of $1,000 and 5% of the apprentice mechanic's income in the taxation year from employment as an apprentice mechanic.

Clause (B) of the description B in the formula in subparagraph 8(1)(*r*)(ii) is amended – for the 2007 and subsequent taxation-years consequential to the introduction of a deduction for tools of a tradesperson (new paragraph 8(1)(*s*)), the new Canada employment credit (new subsection 118(10) of the Act) and the annual $1,000 apprenticeship grant program (which is described in the note accompanying new paragraph 56(1)(*n*.1) of the Act). As amended, clause (B) of the description B is the greater of:

- the total of $500 (the tools deduction in paragraph 8(1)(*s*) for tradespersons) and the amount on which the taxpayer's Canada employment credit under subsection 118(10) for the taxation year is calculated, and
- 5% of the total of
  - the apprentice's income from employment as an eligible apprentice mechanic, computed without reference to the deduction in paragraph (8)(1)(*r*), and
  - the amount by which the amount required by paragraph 56(1)(*n*.1) (apprenticeship incentive grant) to be included in computing the apprentice mechanic income for the taxation year exceeds the amount required by paragraph 60(*p*) of the Act (repaid apprentice grants) to be deducted in computing that income.

In general terms, the deduction for apprentice mechanic tools applies only to the cost of eligible tools that is in excess of the greater of the above two amounts.

This amendment applies, in general, to the 2006 and subsequent taxation years. For the 2006 taxation year only, a special rule applies to integrate the $1,000 threshold amount with the amount, if any, deducted by a taxpayer as a tradesperson's tools expense under paragraph 8(1)(*s*).

Deduction – tradesperson's tools

ITA
8(1)(*s*)

New paragraph 8(1)(*s*) of the Act provides a deduction of up to $500 in respect of the cost of eligible tools acquired in a taxation year by an employed tradesperson. The amount that may be deducted (not exceeding $500) is the amount by which the lesser of

- the tradesperson's income for the taxation year from employment as a tradesperson (including the new apprenticeship incentive grant); and
- the cost of the tradesperson's eligible tools acquired in the year

exceeds

- $1,000 (indexed after 2007).

Eligible tools are described in new subsection 8(6.1).

This amendment applies to the 2006 and subsequent taxation years.

Apprentice mechanics

ITA
8(6)

Subsection 8(6) of the Act provides three special rules for the purpose of the apprentice mechanics' tools deduction in paragraph (8)(1)(*r*). Subparagraph 6(*a*)(i) is amended to clarify that federally registered apprenticeships qualify. Further, the rule in paragraph 8(6)(*b*) – which describes eligible tools – is amended, consequential to the tool deduction in new paragraph 8(1)(*s*) for tradespersons, to exclude from the meaning of eligible tools electronic communication devices and electronic data processing equipment (unless the device or equipment can be used only for the purpose of measuring, locating or calculating).

This amendment applies to tools acquired on or after May 2, 2006.

Eligible tool of tradesperson

ITA
8(6.1)

New subsection 8(6.1) of the Act provides that an eligible tool of a taxpayer – for the purpose of the tools deduction for tradespersons in new paragraph 8(1)(*s*) – is a tool (including ancillary equipment) that

- is acquired by the taxpayer on or after May 2, 2006 for use in connection with the taxpayer's employment as a tradesperson,
- has not been used for any purpose before it is acquired by the taxpayer,
- is certified in prescribed form by the taxpayer's employer to be required to be provided by the taxpayer as a condition of, and for use in, the taxpayer's employment as a tradesperson, and
- is, unless the device or equipment can be used only for the purpose of measuring, locating or calculating, not an electronic communication device or electronic data processing equipment.

This amendment applies to the 2006 and subsequent taxation years.

Cost of tool

ITA
8(7)

Subsection 8(7) of the Act provides that, where an apprentice mechanic is entitled to deduct an amount for a taxation year under paragraph 8(1)(*r*) in respect of eligible tools, the cost to the apprentice mechanic of the tools is reduced *pro rata* by the deductible amount.

Subsection 8(7) is amended to apply also where a tradesperson is entitled to deduct an amount from employment income in respect of eligible tools under new paragraph 8(1)(*s*).

This amendment applies to the 2006 and subsequent taxation years.

Clause 3

Eligible capital property

ITA
14

Section 14 of the Act provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of eligible capital properties and operates on a pooling basis. Annual deductions, which are calculated as a percentage of this pool, may be claimed under paragraph 20(1)(*b*) of the Act. "Eligible capital property" includes goodwill, customer lists, farm quotas and licenses of unlimited duration.

Election re capital gain

ITA
14(1.01)

Subsection 14(1.01) of the Act permits a taxpayer to elect, in the taxpayer's return of income for a taxation year, to report a capital gain on the disposition of an eligible capital property in respect of which the taxpayer can identify the cost of the particular property. Where the taxpayer has so elected, the taxpayer is deemed to have disposed of a capital property with an adjusted cost base equal to that cost, for proceeds of disposition equal to the actual proceeds of the eligible capital property. Paragraph 14(1.01)(*a*) removes the property from the cumulative eligible capital pool by coincidentally deeming the proceeds of disposition of the eligible capital property to be equal to its original cost.

Subsection 14(1.01) is amended to clarify that it is the eligible capital expenditure made by the taxpayer to acquire the eligible capital property that must be verifiable. The amended provision will allow a taxpayer to elect in the taxpayer's return of income for the taxation year of the disposition, or with an election under subsection 83(2) of the Act. This allows a taxpayer to consider the resulting capital gain when making a capital dividend election.

This amendment generally applies to dispositions of eligible capital property that occur in taxation years that end after February 27, 2000.

Eligible capital property – election re capital gain

ITA
14(1.01)(*c*)

Subsection 14(1.01) of the Act, as proposed to be amended as described above, permits a taxpayer to elect, in the taxpayer's return of income for a taxation year, to report a capital gain on the disposition of an eligible capital property in respect of which the taxpayer can identify the eligible capital expenditure made by the taxpayer to acquire the eligible capital property. Where the taxpayer has so elected, the taxpayer is deemed to dispose of a capital property with an adjusted cost base equal to that cost for proceeds of disposition equal to actual proceeds from the disposition of the eligible capital property.

Paragraph 14(1.01)(*c*) provides that, where the eligible capital property is "qualified farm property" (within the meaning assigned by subsection 110.6(1) of the Act), the capital property deemed by subsection 14(1.01) to be disposed of is also deemed to be, at the time of that disposition, a qualified farm property of the taxpayer. That paragraph thus ensures that the resulting capital gain from the disposition may qualify for the capital gains exemption under section 110.6 for qualified farm property.

Paragraph 14(1.01)(*c*) is amended to provide that, where the eligible capital property disposed of is a "qualified farm property" or a "qualified fishing property" (within the meaning assigned by subsection 110.6(1)) of the taxpayer at the time of its disposition, the capital property deemed by subsection 14(1.01) to be disposed of will also be deemed to have been, at that time, a "qualified farm property" or a "qualified fishing property", as the case may be. The amendment is consequential to the introduction of the definition "qualified fishing property" in subsection 110.6(1) and the capital gains deduction in new subsection 110.6(2.2) for qualified fishing property.

This amendment applies to dispositions of property that occur on or after May 2, 2006.

Election re property acquired with pre-1972 outlays or expenditures

ITA
14(1.02)

Subsection 14(1.01) of the Act does not allow a taxpayer to elect under that subsection in respect of a property acquired prior to 1972. New subsection 14(1.02) is added to allow a taxpayer to make a similar election in respect of property that would, if an outlay or expenditure were made after 1971 to acquire the property, be eligible for the election under subsection 14(1.01). For the purposes of calculating the capital gain to the taxpayer under this election, the adjusted cost base of such property is deemed to be nil and the proceeds of disposition would be determined under subsection 21(1) of the *Income Tax Application Rules*.

New subsection 14(1.02) applies to dispositions of eligible capital property that occur after December 20, 2002.

Election re property acquired with pre-1972 outlays or expenditures

ITA
14(1.02)(*c*)

Subsection 14(1.01) of the Act does not allow a taxpayer to elect under that subsection in respect of a property acquired before 1972. Subsection 14(1.02) allows a taxpayer to make a similar election in respect of property that would, if an outlay or expenditure were made after 1971 to acquire the property, be eligible for the election under subsection 14(1.01).

Paragraph 14(1.02)(*c*) provides that, where the eligible capital property is "qualified farm property" (within the meaning assigned by subsection 110.6(1) of the Act), the capital property deemed by subsection 14(1.02) to be disposed of is deemed to be, at the time of that disposition, a qualified farm property of the taxpayer. This is similar to the deeming rule in paragraph 14(1.01)(*c*).

Paragraph 14(1.02)(*c*) is amended to provide that, where the eligible capital property disposed of is a "qualified farm property" or a "qualified fishing property" (within the meaning assigned by subsection 110.6(1)) of the taxpayer at the time of its disposition, the capital property deemed by subsection 14(1.02) to be disposed of will also be deemed to have been, at that time, a "qualified farm property" or a "qualified fishing property", as the case may be. The amendment is consequential to the introduction of the definition "qualified fishing property" in subsection 110.6(1) and the capital gains deduction in new subsection 110.6(2.2) for qualified fishing property.

This amendment applies to dispositions of property that occur on or after May 2, 2006.

Non-application of subsections 14(1.01) and (1.02)

ITA
14(1.03)

New subsection 14(1.03) of the Act is added, concurrently with the amendment of subsection 14(1.01) and the addition of new subsection 14(1.02), to preclude a taxpayer from making an election under those subsections in respect of eligible capital property that is goodwill. Subsection 14(1.03) also precludes an election by a corporation under those subsections for property acquired in circumstances where an election was made under subsection 85(1) or (2) of the Act, if the amount agreed on as the corporation's cost under those subsections was less than the fair market value of the property at the time it was so acquired. However, this rule only applies in circumstances where the corporation is dealing at non-arm's length with the transferor of the property and the eligible capital expenditure of the transferor to acquire the property cannot be determined. The exclusion from electing for property acquired in a rollover prevents the conversion of property with no determinable cost into property with a cost that is determinable for tax purposes.

New subsection 14(1.03) applies generally to dispositions of eligible capital property that occur after February 27, 2004, and in particular to dispositions of goodwill that occur after December 20, 2002.

Deemed capital gain

ITA
14(1.2)

New subsection 14(1.2) of the Act is added consequential to the introduction of the definition "qualified fishing property" in subsection 110.6(1) and the capital gains deduction in new subsection 110.6(2.2) of the Act for qualified fishing property. New subsection 14(1.2) deems certain amounts included in an individual's income for a taxation year in respect of eligible capital property attributable to "qualified fishing property" to be a taxable capital gain of the individual from the disposition of qualified fishing property in the year.

The amount deemed to be a taxable capital gain is limited to the lesser of two amounts. The first amount is the amount included in the taxpayer's income for the year under paragraph 14(1)(*b*) from the fishing business. The second amount (determined in respect of eligible capital property that was, at the time of disposition, a "qualified fishing property" as defined in subsection 110.6(1)) is the amount (to the extent that, that amount had not already been included in the taxpayer's taxable capital gains), if any, by which,

- ½ of the total of all amounts each of which is the taxpayer's proceeds of disposition from dispositions, on or after May 2, 2006, of the eligible capital property

exceeds

- ½ of the total of all amounts each of which is an eligible capital expenditure made in respect of the eligible capital property of the fishing business disposed of or a non-deductible outlay or expense of the taxpayer made in respect of the disposition of the eligible capital properties.

This amendment applies to dispositions of capital property that occur on or after May 2, 2006.

Definition of cumulative eligible capital

ITA
14(5)

The definition "cumulative eligible capital" in subsection 14(5) of the Act provides for the calculation of a taxpayer's cumulative eligible capital property pool for the purpose of determining the taxpayer's allowable deduction in respect of eligible capital property for the year.

Description of E

The description of E in the definition "cumulative eligible capital" is the total of all amounts each of which is ¾ of the amount by which the amount in paragraph (*a*) exceeds the amount in paragraph (*b*). In general terms, amounts included in paragraph (*a*) are amounts a taxpayer is entitled to receive as a result of transferring consideration that is eligible capital property in respect of a business carried on by the taxpayer (or formerly carried on by the taxpayer). Amounts included in paragraph (*b*) are outlays or expenses of the taxpayer that were not otherwise deductible in computing income and which were incurred for the purpose of making the transfer of consideration.

Paragraph (*a*) of the description of E is reworded to clarify that it applies to an amount that is received or receivable by a taxpayer on account of capital in respect of a business carried on by the taxpayer or formerly carried on by the taxpayer, other than to an amount that

- is included in computing the taxpayer's income, or deducted in computing any balance of undeducted outlays, expenses or other amounts,
- reduces the cost or capital cost of property or an outlay or expense, or
- is included in computing any gain or loss of the taxpayer from a disposition of capital property.

Paragraph (*b*) of the description of E is amended consequential to the amendment to paragraph (*a*).

This amendment - which is consequential to the extension of the $500,000 capital gains deduction to certain capital gains realized by an individual who disposes of qualified fishing property – generally applies to amounts that become receivable on or after May 2, 2006.

Clause 4

Reserve - property disposed of to a child

ITA
40(1.1)

Section 73 of the Act provides that an individual may dispose of certain farm or small business properties – i.e., certain land or depreciable property used for farming, shares of the capital stock of a family farm corporation, an interest in a family farm partnership and shares of a small business corporation – to the individual's children on a tax-deferred rollover basis or on a taxable basis, depending upon whether certain conditions are met. Where that disposition is not made on a rollover basis and a gain arises, subsection 40(1.1) of the Act provides that the taxpayer may claim a reserve over a maximum ten-year period.

Subsection 40(1.1) is amended to extend the application of this provision to dispositions by a taxpayer to their children, of land or depreciable property in Canada of a prescribed class, that was used in the business of fishing by the taxpayer (or by the taxpayer's spouse or common-law partner, a child of the taxpayer or a parent of the taxpayer), shares of the capital stock of a family fishing corporation of the taxpayer and interests in a family fishing partnership of the taxpayer (such a share or interest having the meaning assigned by subsection 70(10)) of the Act.

This amendment generally applies to dispositions of property that occur on or after May 2, 2006.

Clause 5

Reserve – former property disposed of to a child

ITA
44(1.1)

Section 44 of the Act provides special rules where a capital property, such as real property, used in a business is replaced. In this case, under subsection 44(1) any capital gain arising on the disposition of a qualifying property (referred to in subparagraph 44(1)(*e*)(iii) as a "former property") is reduced to the extent that the proceeds of disposition are reinvested in a replacement property. Where only a part of the proceeds is reinvested, a partial rollover is available. Where the proceeds are not received in full, subsection 44(1) also provides for the deduction of a capital gains reserve. Under subsection 44(1.1) the maximum reserve is ten years where the property was "qualified farm property" disposed of by a taxpayer to a child of the taxpayer.

Subsection 44(1.1) is amended to extend this reserve treatment to "qualifying fishing property". This ensures that, in determining a taxpayer's capital gain from a disposition (to which subsection 73(3.1) of the Act applied) on or after May 2, 2006 of a former property (referred to in subparagraph 44(1)(*e*)(iii)) that is a fishing property to a child of the taxpayer, the taxpayer will be permitted to claim a reserve over a maximum ten-year period in respect of the proceeds of disposition that have not been received.

This amendment generally applies to dispositions of property that occur on or after May 2, 2006.

Clause 6

Other sources of income

ITA
56

Section 56 of the Act provides a list of certain types of income that are required to be included in computing the income of a taxpayer under paragraph 3(*a*) of the Act from sources that are not an office or employment, a business or a property.

Eligible tools of an employee, re proceeds

ITA
56(1)(*k*)

Paragraph 56(1)(*k*) of the Act provides a rule that applies to all amounts received by a person (vendor) in respect of certain tools if the vendor was entitled to an apprentice mechanics' tools deduction for those tools under paragraph 8(1)(*r*) of the Act, or the recipient is a person who does not deal at arm's length with the apprentice mechanic (e.g., a spouse or common-law partner, son or daughter).

Paragraph 56(1)(*k*) is amended consequential to the introduction of a deduction for eligible tools of a tradesperson under new paragraph 8(1)(*s*).

This amendment applies to the 2006 and subsequent taxation years.

Apprenticeship incentive grant

ITA
56(1)(*n.1*)

New paragraph 56(1)(*n.1*) of the Act requires a taxpayer to include in computing income for a taxation year amounts received in the year under the Apprenticeship Incentive Grant program administered by the Department of Human Resources and Social Development.

This amendment applies to the 2007 and subsequent taxation years.

Scholarships and bursaries

ITA
56(3)

Subsection 56(3) of the Act provides for an annual exemption for up to $3,000 of amounts received by an individual in connection with the individual's enrolment at a designated educational institution in a program in respect of which the individual may claim the education tax credit.

Subsection 56(3) is amended to exclude from income all such amounts received by an individual in a taxation year, without limit.

This amendment applies to the 2006 and subsequent taxation years.

CPP/QPP and UCCB amounts for previous years

ITA
56(8)

Subsection 56(8) of the Act allows an individual to exclude from income for the taxation year of receipt certain CPP/QPP disability benefits that relate to one or more prior years (except where the prior year benefits are less than $300) and to pay tax on those benefits as if they had been received in the years to which they relate.

This amendment broadens the application of subsection 56(8) such that it will also apply to benefits received under the *Universal Child Care Benefit Act*.

This amendment applies to the 2006 and subsequent taxation years.

Clause 7

Deductions in computing income

ITA
60

Section 60 of the Act provides for various deductions in computing income, including deductions in respect of certain repayments.

Repayment of apprenticeship incentive grant

ITA
60(*p*)

New paragraph 60(*p*) of the Act provides that a taxpayer may deduct a repayment made under the Apprenticeship Incentive Grant program.

This amendment applies to the 2007 and subsequent taxation years.

Clause 8

Child care expense

ITA
63

Section 63 of the Act provides rules concerning the deductibility of child care expenses in computing a taxpayer's income.

Earned income

ITA
63(3)(*b*)

Subsection 63(3) of the Act contains the definition "earned income". Paragraph 63(3)(*b*) of that definition is amended – consequential to the new apprentice grant program – to include in a taxpayer's earned income an apprentice grant included in computing the taxpayer's income under paragraph 56(1)(*n.1*) of the Act.

This amendment applies to the 2007 and subsequent taxation years.

Clause 9

Disability supports deduction

ITA
64

Section 64 of the Act permits the deduction of disability supports expenses incurred to enable the taxpayer to work, to attend secondary school or to attend a designated educational institution, unless they have been reimbursed by a non-taxable payment. The effect of this deduction is that no income tax is payable on income (including government assistance) used to pay for these expenses, and that this income is not used in determining the value of income-tested benefits.

Clauses 64(1)(*a*)A(ii)(F) to (H) were amended in June 2006 to change the references to "mental or physical impairment" to "impairment in physical or mental functions". Clause 64(1)(*a*)A(ii)(J) in now amended to change the reference to "mental or physical infirmity" to "impairment in physical or mental functions".

This amendments apply to the 2005 and subsequent taxation years.

Clause 10

Transfer of farm and fishing property to child

ITA
70(9) and (9.01)

Subsection 70(9) of the Act provides rules allowing a rollover of capital gains on intergenerational transfers of farm property from a taxpayer to a child of the taxpayer as a result of the death of the taxpayer.

The Act is amended to split subsection 70(9) into two subsections, namely, new subsections 70(9) and (9.01). Subsection 70(9) identifies the circumstances under which subsection 70(9.01) will apply. Taken together, those subsections allow for a tax deferred rollover of capital gains and recaptured depreciation on an intergenerational transfer of certain farm and fishing properties from a taxpayer to a child of the taxpayer as a result of the death of the taxpayer.

New subsection 70(9) provides that, for a transfer on or after May 2, 2006 of a property, the rollover rules in new subsection 70(9.01) will apply to the deceased taxpayer and the child in respect of the property where

- the property was land or depreciable property of a prescribed class of the taxpayer that was before the death of the taxpayer used principally in a farming or fishing business carried on in Canada in which the taxpayer, the taxpayer's spouse or common-law partner, a child of the taxpayer or a parent of the taxpayer was actively engaged on a regular and continuous basis (or in the case of a property used in a woodlot, was engaged to the extent required by the prescribed forest management plan in respect of the woodlot),

- the child was resident in Canada immediately before the taxpayer's death, and
- as a consequence of the death of the taxpayer, the property is transferred to the child of the taxpayer and the property has become vested indefeasibly in the child on any day within the period ending 36 months after the death of the taxpayer or, if written application is made by the taxpayer's legal representative within that period, such longer period that the Minister of National Revenue considers reasonable in the circumstances.

New subsection 70(9.01) provides the following where the requirements in subsection 70(9) are met:

- Section 69 and subsection 70(5) of the Act do not apply to the taxpayer and the child in respect of the property;
- The taxpayer is deemed to have, immediately before death, disposed of the property and to have received proceeds of disposition as determined under paragraph 70(9.01)(*a*) or (*b*). The child is deemed to have, immediately after the time of the disposition, acquired the property for an amount equal to the amount of those proceeds of disposition; and
- Paragraph 70(9.01)(*b*) will apply to the taxpayer in respect of the property if the taxpayer's personal representative elects, in the taxpayer's return of income for the taxation year in which the taxpayer died, to have that paragraph apply. Otherwise, paragraph 70(9.01)(*a*) will apply to the taxpayer in respect of the property.

If paragraph 70(9.01)(*a*) applies,

- where the property was a depreciable property of a prescribed class of the taxpayer, the taxpayer is deemed to have, immediately before death, disposed of the property and to have received proceeds of disposition equal to the lesser of
  - the capital cost to the taxpayer of the property, and
  - the amount, determined immediately before the time of the disposition of the property, that is that proportion of the undepreciated capital cost of the property of that class to the taxpayer that the capital cost to the taxpayer of the property is of the capital cost to the taxpayer of all property of that class that had not, at or before that time, been disposed of, and
- where the property is land, the taxpayer is generally deemed to have, immediately before death, disposed of the property and to have received proceeds of disposition equal to the taxpayer's adjusted cost base of the property immediately before the death.
- where the property was depreciable property of a prescribed class, paragraphs 70(5)(*c*) and (*d*) apply to the taxpayer and the child in respect of the property as if the references in those paragraphs to "paragraph (*a*)" and "paragraph (*b*)" were read as references to "subparagraph (9.01)(*a*)(ii)" and "subparagraph (9.01)(*a*)(iii)", respectively.

If paragraph 70(9.01)(*b*) applies, the proceeds of disposition deemed to have been received by the taxpayer is the amount that the legal representative designates, which designated amount must not be greater than the greater of nor less than the lesser of

- where the property was depreciable property of a prescribed class,
  - the fair market value of the property immediately before the time of the disposition of the property, and
  - the lesser of the capital cost to the taxpayer of the property and the amount, determined immediately before the time of the disposition of the property, that is that proportion of the undepreciated capital cost of the property of that class to the taxpayer that the capital cost to the taxpayer of the property is of the capital cost to the taxpayer of all property of that class that had not, at or before that time, been disposed of, and

- where the property was land, generally
  - the fair market value of the property immediately before the time of the disposition, and
  - the adjusted cost base to the taxpayer of the property immediately before the time of the disposition.
- where the property was depreciable property of a prescribed class, paragraphs 70(5)(*c*) and (*d*) apply to the taxpayer and the child in respect of the property as if the references in those paragraphs to "paragraph (*a*)" and "paragraph (*b*)" were read as references to "subparagraph (9.01)(*b*)(ii)" and "subparagraph (9.01)(*b*)(iii)", respectively.
- where the amount designated by the taxpayer's legal representative to be the taxpayer's proceeds of disposition of a property exceeds the greater of the amounts provided under subsubclauses 70(9)(*b*)(ii)(B)(I)1. and 2. or subsubclauses 70(9)(*b*)(ii)(B)(II)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the greater of the amounts determined under those subsubclauses in respect of the property.
- where the amount designated by the taxpayer's legal representative to be the taxpayer's proceeds of disposition of a property is less than the lesser of the amounts provided under subsubclauses 70(9)(*b*)(ii)(B)(I)1. and 2. or subsubclauses 70(9)(*b*)(ii)(B)(II)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the lesser of the amounts determined under those subsubclauses in respect of the property.

This amendment applies to dispositions of property that occur on or after May 2, 2006, unless the disposition of the property was before 2007 and the taxpayer elects in writing in the taxpayer's return of income for the taxation year in which the disposition occurred to have subsection 70(9), as that subsection read on May 1, 2006, apply to the disposition of the property.

Transfer of farming and fishing property from trust to settlor's children

ITA
70(9.1) and (9.11)

Subsection 70(9.1) of the Act provides rules allowing a rollover of capital gains on intergenerational transfers of farm property from spousal or common-law partner trust in respect of a taxpayer that is the settlor of the trust to a child of the taxpayer as a result of the death of the taxpayer's spouse or common-law partner who is the beneficiary under the trust.

The Act is amended to split subsection 70(9.1) into two subsections, namely, new subsections 70(9.1) and (9.11). Subsection 70(9.1) identifies the circumstances under which subsection (9.11) applies. Taken together, those subsections provide rules allowing a tax-deferred transfer on intergenerational transfers of certain fishing and farming properties from spousal or common-law partner trusts to a child of the taxpayer as a consequence of the death of the taxpayer's spouse or common-law partner.

New subsection 70(9.1) provides that new subsection (9.11) will apply to a trust and the child of the settlor of the trust in respect of a transfer of a property of the trust to a child of the settlor of the trust as a consequence of the death of the beneficiary of the trust who is the spouse or common-law partner of the settlor where

- the property (or property for which the property was substituted) was transferred to the trust by the settlor,
- subsection 70(6) or 73(1) of the Act (as that subsection applied to transfers before 2000) or subparagraph 73(1.01)(*c*)(i) applied to the settlor and the trust in respect of the transfer of the property to the trust,
- the property was, immediately before the beneficiary's death, land or depreciable property of a prescribed class of the trust that was used in a fishing or farming business carried on in Canada,

- the child of the settlor was, immediately before the beneficiary's death, resident in Canada, and
- as a consequence of the beneficiary's death, the property is transferred to the child and becomes vested indefeasibly in the child within the period ending 36 months after the beneficiary's death or, if written application has been made to the Minister of National Revenue by the taxpayer's legal representative within that period, within any longer period that the Minister considers reasonable in the circumstances.

New subsection 70(9.11) provides the following where the requirements in subsection 70(9.1) are met:

- Section 69 and subsections 104(4) and (5) of the Act do not apply to the taxpayer and the child in respect of the property;
- The trust is deemed to have disposed of the property immediately before the beneficiary's death and to have received proceeds of disposition determined under paragraph 70(9.11)(*a*) or (*b*). The child is deemed to have, immediately after the time of the disposition, acquired the property at a cost equal to the trust's proceeds of disposition in respect of the disposition of the property; and
- Paragraph 70(9.11)(*b*) will apply to the taxpayer in respect of the property if the trust elects, in the trust's return of income for the taxation year in which the beneficiary died, to have that paragraph apply. Otherwise, paragraph 70(9.11)(*a*) will apply to the trust in respect of the property.

If paragraph 70(9.11)(*a*) applies,

- where the property was depreciable property of a prescribed class of the trust, the trust is deemed to have disposed of the property for proceeds of disposition equal to the lesser of
  - the capital cost to the trust of the property, and
  - the amount, determined immediately before the time of the disposition of the property, that is that proportion of the undepreciated capital cost of property of that class to the trust that the capital cost to the trust of the property is of the capital cost to the trust of all property of that class that had not, at or before that time, been disposed of, and
- where the property was land of the trust, the trust is generally deemed to have disposed of the property for proceeds of disposition equal to the trust's adjusted cost base of the land immediately before the time of the disposition.

If paragraph 70(9.11)(*b*) applies, the trust is deemed to have disposed of the property and received proceeds of disposition, in respect of the disposition of the property equal to such amount as the trust designates provided that the amount designated is not greater than the greater of nor less than the lesser of

- where the property was depreciable property of a prescribed class, the lesser of
  - the fair market value of the property immediately before the time of the disposition of the property, and
  - the lesser of the capital cost to the trust of the property and the amount, determined immediately before the time of the disposition of the property, that is that proportion of the undepreciated capital cost of property of that class to the trust that the capital cost to the trust of the property is of the capital cost to the trust of all property of that class that had not, at or before that time, been disposed of, and
- where the property was land, generally
  - the trust's adjusted cost base of the property immediately before the time of the disposition, and
  - the fair market value of the property immediately before the time of the disposition.
- where the amount designated by the trust to be the trust's proceeds of disposition of a property exceeds the greater of the amounts provided under subsubclauses 70(9.11)(*b*)(ii)(B)(I)1. and 2. or subsubclauses 70(9.11)(*b*)(ii)(B)(II)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the greater of the amounts determined under those subsubclauses in respect of the property.

- where the amount designated by the trust to be the trust's proceeds of disposition of a property is less than the lesser of the amounts provided under subsubclauses 70(9.11)(*b*)(ii)(B)(I)1. and 2. or subsubclauses 70(9.11)(*b*)(ii)(B)(II)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the lesser of the amounts determined under those subsubclauses in respect of the property.
- the child's capital cost of a depreciable property acquired from the trust is deemed to be the capital cost of the property to the trust immediately before the disposition and if that capital cost to the trust of the property exceeds the cost of the property to the child, the excess is deemed to be capital cost allowance allowed to the child for the purposes of sections 13 and 20 of the Act and any regulations made under paragraph 20(1)(*a*).
- where the trust's proceeds of disposition of a depreciable property are redetermined under subsection 13(21.1) and the trust's capital cost, immediately before the disposition, exceeds the amount so redetermined under subsection 13(21.1), for the purposes of sections 13 and 20 and any regulations made under paragraph 20(1)(*a*), the child's capital cost of the property immediately after the time of disposition is deemed to be the amount that was the capital cost of the property, to the trust, immediately before the disposition and the excess is deemed to be capital cost allowance allowed to the child.
- where the trust's proceeds of disposition of land are redetermined under subsection 13(21.1), the child's cost of the property is deemed to be the amount that was the trust's proceeds of disposition of the property redetermined under subsection 13(21.1).

This amendment applies to dispositions of property that occur on or after May 2, 2006, unless the disposition of the property was before 2007 and the taxpayer elects in writing in the taxpayer's return of income for the taxation year in which the disposition occurred to have subsection 70(9.1), as that subsection read on May 1, 2006, apply to the disposition of the property.

Transfer of family farm and fishing corporations and partnerships

ITA
70(9.2) and (9.21)

Subsection 70(9.2) of the Act sets out certain rules that apply to the transfer of a share of a family farm corporation or an interest in a family farm partnership on the death of a taxpayer where the transfer is to a child of the taxpayer.

The Act is amended to split subsection 70(9.2) into two subsections, namely, new subsections 70(9.2) and (9.21). Subsection 70(9.2) identifies the circumstances under which subsection 70(9.21) applies. Taken together, those subsections allow the transfer of a share of the capital stock of a family fishing corporation or a family farm corporation or an interest in a family fishing partnership or a family farm partnership, on the death of a taxpayer where the transfer is to a child of the taxpayer.

New subsection 70(9.2) provides that, in the case of a transfer of a share of a family fishing corporation, a share of a family farm corporation, an interest in a family fishing partnership or an interest in a family farm partnership, of a taxpayer, to a child of the taxpayer as a consequence of the death of the taxpayer, new subsection 70(9.21) will apply to the taxpayer and the child in respect of the property if

- the property was, immediately before the taxpayer's death, a share of the capital stock of a family fishing corporation or of a family farm corporation, of the taxpayer, or an interest in a family fishing partnership or in a family farm partnership, of the taxpayer (as those expressions are defined in subsection 70(10));
- the child was resident in Canada immediately before the taxpayer's death; and
- as a consequence of the taxpayer's death, the property is transferred to the child and becomes vested indefeasibly in the child within the period ending 36 months after the taxpayer's death or, if written application has been made to the Minister of National Revenue by the taxpayer's legal representative within that period, within any longer period that the Minister considers reasonable in the circumstances.

New subsection 70(9.21) provides the following where the requirements in subsection 70(9.2) are met:

- Section 69 and paragraphs 70(5)(*a*) and (*b*) of the Act do not apply to the taxpayer and the child in respect of the property;
- The taxpayer is deemed to have, immediately before death, disposed of the property and received proceeds of disposition determined under either paragraph 70(9.21)(*a*) or (*b*); and
- Paragraph 70(9.21)(*b*) will apply to the taxpayer in respect of the property if the taxpayer's legal representative elects, in the taxpayer's return of income for the taxation year in which the taxpayer died, to have that paragraph apply. Otherwise, paragraph 70(9.21)(*a*) will apply to the taxpayer in respect of the property.

If paragraph 70(9.21)(*a*) applies,

- where the property was, immediately before the taxpayer's death, a share of the capital stock of a family fishing corporation, or a share of the capital stock of a family farm corporation, of the taxpayer,
  - the taxpayer is deemed to have disposed of the property and received proceeds of disposition equal to the taxpayer's adjusted cost base of the property immediately before the taxpayer's death, and
  - the child is, immediately after the time of the disposition, deemed to have acquired the property at a cost equal to the taxpayer's proceeds of disposition, and
- where the property was, immediately before the taxpayer's death, an interest in a family fishing partnership or an interest in a family farm partnership, of the taxpayer,
  - the taxpayer is (except for the purpose of paragraph 98(5)(*g*) of the Act) deemed not to have disposed of the property as a consequence of the taxpayer's death,
  - the child is deemed to have acquired the property at the time of the taxpayer's death at a cost equal to the cost to the taxpayer of the interest immediately before the time that is immediately before the time of the taxpayer's death, and
  - each amount required to be added or deducted by subsection 53(1) or (2) of the Act in computing the adjusted cost base to the taxpayer of the property shall be deemed to be required by subsection 53(1) or (2) to be added or deducted, as the case may be, in computing the child's adjusted cost base of the property.

If paragraph 70(9.21)(*b*) applies,

- where the property is, immediately before the taxpayer's death, a share of the capital stock of a family fishing corporation, or a share of the capital stock of a family farm corporation, of the taxpayer,
  - the taxpayer is deemed to receive proceeds of disposition in respect of the disposition of the property equal to such amount as the taxpayer's legal representative designates, provided that the amount designated is not greater than the greater of nor less than the lesser of
    - the property's fair market value immediately before the taxpayer's death, and
    - the adjusted cost base of the property to the taxpayer immediately before the time of that disposition, and
  - the child is, immediately after the time of the disposition, deemed to have acquired the property at a cost equal to the taxpayer's proceeds of disposition, and
- where the amount designated by the taxpayer's representative to be the taxpayer's proceeds of disposition of a property exceeds the greater of the amounts provided under subsubclauses 70(9.21)(*b*)(ii)(A)(II)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the greater of the amounts determined under those subsubclauses in respect of the property,

- where the amount designated by the taxpayer's representative to be the taxpayer's proceeds of disposition of a property is less than the lesser of the amounts provided under subsubclauses 70(9.21)(*b*)(ii)(A)(I)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the lesser of the amounts determined under those subsubclauses in respect of the property,
- where the property is, immediately before the taxpayer's death, an interest in a family fishing partnership, or an interest in a family farm partnership, of the taxpayer (other than a partnership interest to which subsection 100(3) of the Act applies),
  - the taxpayer is (except for the purpose of paragraph 98(5)(*g*)) deemed not to have disposed of the property as a consequence of the taxpayer's death,
  - the child is deemed to have acquired the property at the time of the taxpayer's death at a cost equal to the cost to the taxpayer of the interest immediately before the time that is immediately before the time of the taxpayer's death, and
  - each amount required to be added or deducted by subsection 53(1) or (2) in computing the adjusted cost base to the taxpayer of the property shall be deemed to be required by subsection 53(1) or (2) to be added or deducted, as the case may be, in computing the child's adjusted cost base of the property.

This amendment applies to dispositions of property that occur on or after May 2, 2006, unless the disposition of the property was before 2007 and the taxpayer elects in writing in the taxpayer's return of income for the taxation year in which the disposition occurred to have subsection 70(9.2), as that subsection read on May 1, 2006, apply to the disposition of the property.

Transfer of family farm or fishing corporation or family farm or fishing partnership from trust to children of settlor

ITA
70(9.3) and (9.31)

Subsection 70(9.3) of the Act provides rules allowing a rollover of capital gains on an intergenerational transfer of a share of the capital stock of a family farm corporation or interest in a family farm partnership of a taxpayer that is a settlor of a spousal or a common-law partner trust, where the transfer of that share or interest is from the spousal or common-law partner trust to a child of the taxpayer as a consequence of the death of the beneficiary under the trust who is the spouse or common-law partner of the taxpayer.

The Act is amended to split subsection 70(9.3) into two subsections, namely, new subsections 70(9.3) and 70(9.31). Subsection 70(9.3) identifies the circumstances under which subsection 70(9.31) applies. Taken together, those subsections allow a capital gains rollover in respect of a share of the capital stock of a family fishing corporation or of a family farm corporation of the settlor or an interest in a family fishing partnership or in a family farm partnership of the settlor, from the spousal or common-law partner trust created to a child of the settlor as a consequence of the beneficiary's death of the trust that is the spouse or common-law partner.

New subsection 70(9.3) provides that new subsection 70(9.31) will apply (and subsection 104(4) of the Act will not apply), as a consequence of the death of a beneficiary under the trust who was the spouse or common-law partner of the settlor of the trust, in respect of a property of the trust if,

- the property (or property for which the property was substituted) was transferred to the trust by the settlor, and was, immediately before that transfer, a share of the capital stock of a family farm corporation or a share of the capital stock of a family fishing corporation, of the settlor, an interest in a family farm partnership or an interest in a family fishing partnership, of the settlor,
- subsections 70(6) and 73(1) of the Act (as that subsection applied to transfers before 2000) or subparagraph 73(1.01)(*c*)(i) applied to the settlor and the trust in respect of that transfer of the property,
- the property was, immediately before the beneficiary's death (i.e., the spouse or common-law partner of the taxpayer),

- a share of the capital stock of a Canadian corporation that would, immediately before the beneficiary's death, be a share of the capital stock of a family farm corporation of the settlor, if the settlor owned the share at that time and paragraph (*a*) of the definition "share of the capital stock of a family farm corporation", in subsection 70(10), were read without the words "in which the person or a spouse or common-law partner, child or parent of the person was actively engaged on a regular and continuous basis (or in the case of property used in the operation of a woodlot, was engaged to the extent required by a prescribed forest management plan in respect of that woodlot)",
- a share of the capital stock of a Canadian corporation that would, immediately before the beneficiary's death, be a share of the capital stock of a family fishing corporation of the settlor, if the settlor owned the share at that time and paragraph (*a*) of the definition "share of the capital stock of a family fishing corporation", in subsection 70(10), were read without reference to the words "in which the individual, the individual's spouse or common-law partner, or a child or a parent of the individual was actively engaged on a regular and continuous basis", or
- a partnership interest in a partnership that carried on the business of farming or fishing in Canada in which it used all or substantially all of the property,

- the child of the settlor was, immediately before the beneficiary's death, resident in Canada, and
- as a consequence of the beneficiary's death, the property is transferred to the child and becomes vested indefeasibly in the child within the period ending 36 months after the beneficiary's death or, if written application has been made to the Minister of National Revenue by the taxpayer's legal representative within that period, within any longer period that the Minister considers reasonable in the circumstances.

New subsection 70(9.31) provides the following where the requirements in subsection 70(9.3) are met:

- Section 69 and subsection 104(4) of the Act do not apply to the trust and the child in respect of the property;
- The trust is deemed to have disposed of the property immediately before the beneficiary's death and to have received proceeds of disposition determined under paragraph 70(9.31)(*a*) or (*b*); and
- Paragraph 70(9.31)(*b*) will apply to the taxpayer in respect of the property if the trust elects, in the trust's return of income for the taxation year in which the beneficiary died, to have that paragraph apply. Otherwise, paragraph 70(9.31)(*a*) will apply to the trust in respect of the property.

If paragraph 70(9.31)(*a*) applies,

- where the property was a share of the capital stock of a Canadian corporation that would immediately before the beneficiary's death, be a share of the capital stock of a family farm corporation of the settlor under the conditions in subparagraph 70(9.3)(*c*)(i), or a share of the capital stock of a Canadian corporation that would, immediately before the beneficiary's death, be a share of the capital stock of a family fishing corporation of the settlor, under the conditions in subparagraph 70(9.3)(*c*)(ii),
  - the trust is deemed to have disposed of the property immediately before the beneficiary's death, and to have received proceeds of disposition equal to the adjusted cost base to the trust of the property immediately before the time of that disposition, and
  - the child is, immediately after the time of the disposition, deemed to have acquired the property at a cost equal to the trust's proceeds of disposition in respect of that disposition, and

- where the property was, immediately before the beneficiary's death, a partnership interest in a partnership that carried on the business of farming or fishing in Canada in which it used all or substantially all of the property (other than a partnership interest in a partnership to which subsection 100(3) of the Act applies),
  - the trust is, (except for the purpose of paragraph 98(5)(*g*) of the Act) deemed not to have disposed of the property as a consequence of the beneficiary's death,
  - the child is, at the time of the beneficiary's death, deemed to have acquired the property at a cost equal to the cost to the trust of the interest, immediately before that time, and
  - each amount required to be added or deducted by subsection 53(1) or (2) immediately before the beneficiary's death, in computing the adjusted cost base to the trust of the property shall be deemed to be required by subsection 53(1) or (2) to be added or deducted, at or after the time of the beneficiary's death, in computing the child's adjusted cost base of the property.

If paragraph 70(9.31)(*b*) applies,

- where the property was a share of the capital stock of a Canadian corporation that would immediately before the beneficiary's death, be a share of the capital stock of a family farm corporation of the settlor under the conditions in subparagraph 70(9.3)(*c*)(i), or a share of the capital stock of a Canadian corporation that would, immediately before the beneficiary's death, be a share of the capital stock of a family fishing corporation of the settlor, under the conditions in subparagraph 70(9.3)(*c*)(ii), the trust is deemed to have
  - disposed of the property immediately before the beneficiary's death, and
  - received proceeds of disposition that are equal to the amount that the trust designates, provided that the amount designated is not greater than the greater of nor less than the lesser of
    - the fair market value of the property immediately before the beneficiary's death, and
    - the adjusted cost base to the trust of the property immediately before the beneficiary's death,
  - the child is, immediately after the time of the disposition, deemed to have acquired the property at a cost equal to the trust's proceeds of disposition in respect of that disposition of the property, and
- where the amount designated by the trust to be the trust's proceeds of disposition of a property exceeds the greater of the amounts provided under subsubclauses 70(9.31)(*b*)(ii)(A)(II)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the greater of the amounts determined under those subsubclauses in respect of the property.
- where the amount designated by the trust to be the trust's proceeds of disposition of a property is less than the lesser of the amounts provided under subsubclauses 70(9.31)(*b*)(ii)(A)(I)1. and 2. in respect of the property, the taxpayer's proceeds of disposition of the property are deemed to be the lesser of the amounts determined under those subsubclauses in respect of the property.
- where the property was, immediately before that beneficiary's death, a partnership interest in a partnership that carried on the business of farming or fishing in Canada in which it used all or substantially all of the property (other than a partnership interest in a partnership to which subsection 100(3) of the Act applies),
  - the trust is, (except for the purpose of paragraph 98(5)(*g*) of the Act) deemed not to have disposed of the property as a consequence of the beneficiary's death,
  - the child is, at the time of the beneficiary's death, deemed to have acquired the property at a cost equal to the cost to the trust of the interest, immediately before the time that is immediately before the beneficiary's death, and
  - each amount required to be added or deducted by subsection 53(1) or (2), immediately before the beneficiary's death, in computing the adjusted cost base to the trust of the property shall be deemed to be required by subsection 53(1) or (2) to be added or deducted, at or after the time of the beneficiary's death, in computing the child's adjusted cost base of the property.

This amendment applies to dispositions of property that occur on or after May 2, 2006, unless the disposition of the property was before 2007 and the taxpayer elects in writing in the taxpayer's return of income for the taxation year in which the disposition occurred to have subsection 70(9.3), as that subsection read on May 1, 2006, apply to the disposition of the property.

Transfer to a parent

ITA
70(9.6)

Subsection 70(9.6) of the Act provides for a tax-deferred rollover under subsection 70(9) or (9.2) (read with necessary changes) of certain property from a child to a parent where the child dies before the parent. The rules are applicable to farm property in circumstances where the child received the property as a result of the death of a parent or by an *inter vivos* transfer from a parent and any of subsections 70(9), (9.1), (9.2), (9.3) and 73(3) and (4) of the Act applied. The rules provide that such property can be transferred back to either of the child's parents for proceeds of disposition equal to an elected amount that is between the cost to the child of the property and the fair market value of the property at the time of the child's death. The cost to the parent will be equal to the elected amount.

Subsection 70(9.6) is amended to change the references to subsections 70(9), (9.1), (9.2), (9.3) and 73(3) and (4) to references to new subsections 70(9.01), (9.11), (9.21), (9.31) and 73(3.1) and (4.1).

Because of the expanded scope of the new subsections 70(9.1) and (9.21), new subsection 70(9.6) now results in the same treatment being available to fishing property as well.

The amendment to subsection 70(9.6) applies to dispositions of property that occur on or after May 2, 2006.

Leased farm and fishing property

ITA
70(9.8)

Subsection 70(9.8) of the Act treats, for the purposes described in that subsection, property owned by a taxpayer and used by a family farm corporation or a family farm partnership of the taxpayer, his or her spouse or common-law partner, or any of his or her children in the business of farming, as property used by the taxpayer in the business of farming.

Subsection 70(9.8) is amended to provide that, for the purposes of subsections 14(1), paragraph 20(1)(*b*), subsections 70(9) and 73(3), and paragraph (*d*) of the definitions "qualified fishing property" and "qualified farm property" in subsection 110.6(1) of the Act, property of an individual is deemed to be used by the individual in the business of fishing or farming, as the case may be, where the property was used in the course of carrying on a business of fishing or farming, as the case may be, in Canada by

- a corporation, a share of the capital stock of which is a share of the capital stock of a family fishing corporation or of a family farm corporation, of the individual, the individual's spouse or common-law partner, any of the individual's children or the individual's parent, or
- a partnership, an interest in which is an interest in a family fishing partnership or in a family farm partnership, of the individual, the individual's spouse or common-law partner, any of the individual's children, or the individual's parent.

The amendment generally applies to dispositions of property that occur on or after May 2, 2006.

Definitions

ITA
70(10)

Subsection 70(10) of the Act sets out a number of definitions that apply in section 70. The definition "interest in a family farm partnership" is amended, and the definitions "interest in a family fishing partnership" and "share of the capital stock of a family fishing corporation" are added to that subsection, applicable to dispositions of property that occur on or after May 2, 2006, unless the disposition of the property was before 2007 and the taxpayer elects in writing in the taxpayer's return of income for the taxation year in which the disposition occurred to have subsection 70(9), (9.1), (9.2) or (9.3), as that subsection read on May 1, 2006, apply to the disposition of the property.

"interest in a family farm partnership"

"Interest in a family farm partnership" of an individual at any time means a partnership interest owned by the individual at that time if, at that time, all or substantially all of the fair market value of the property of the partnership was attributable to

(a) property that has been used principally in the course of carrying on a farming business in Canada by a qualifying entity in respect of the individual, in which the individual, the individual's spouse or common-law partner, a child of the individual, or a parent of the individual was actively engaged on a regular and continuous basis (or, in the case of property used in the operation of a woodlot, was engaged to the extent required by a prescribed forest management plan in respect of that woodlot),

(b) shares of the capital stock or indebtedness of one or more corporations all or substantially all of the fair market value of the property of which was attributable to property described in (d),

(c) partnership interests or indebtedness of one or more partnerships all or substantially all of the fair market value of the property of which was attributable to property described in (d), and

(d) properties described in any of (a) to (c).

For this purpose, a qualifying entity in respect of the individual is the partnership, a corporation (a share of the capital stock of which was a share of the capital stock of a family farm corporation of the individual or of a spouse or common-law partner, child or parent of the individual), another partnership (a partnership interest which is an interest in a family farm partnership of the individual or of a spouse or common-law partner, child or parent of the individual), and the individual, the individual's spouse or common-law partner, child or parent.

"interest in a family fishing partnership"

"Interest in a family fishing partnership" of an individual is defined to mean a partnership interest owned by the individual where all or substantially all of the fair market value of the property of the partnership is attributable to

(a) property that has been used principally in the course of carrying on a fishing business in Canada by a qualifying entity in respect of the individual, in which the individual, the individual's spouse or common-law partner, the individual's child, or the individual's parent was actively engaged on a regular and continuous basis,

(b) shares of the capital stock or indebtedness of one or more corporations all or substantially all of the fair market value of the property of which was attributable to property described in (d),

(c) partnership interests or indebtedness of one or more partnerships all or substantially all of the fair market value of the property of which was attributable to property described in (d), and

(d) properties described in any of (a) to (c).

For this purpose, a qualifying entity in respect of an individual is the partnership, a corporation (a share of the capital stock of which was a share of the capital stock of a family fishing corporation of the individual or of a spouse or common-law partner, child or parent of the individual), another partnership (a partnership interest which is an interest in a family fishing partnership of the individual or of a spouse or common-law partner, child or parent of the individual), and the individual, the individual's spouse or common-law partner, child or parent.

"share of the capital stock of a family fishing corporation"

"Share of the capital stock of a family fishing corporation" of an individual is defined to mean a share of the capital stock of a corporation owned by the individual where all or substantially all of the fair market value of the property owned by the corporation was attributable to

(a) property that has been used principally in the course of carrying on a fishing business in Canada by a qualifying entity in respect of the individual in which the individual or a spouse or common-law partner, child or parent of the individual was actively engaged on a regular and continuous basis,

(b) shares of the capital stock or indebtedness of one or more corporations all or substantially all of the fair market value of the property of which was attributable to property described in (d),

(c) partnership interests or indebtedness of one or more partnerships all or substantially all of the fair market value of the property of which was attributable to property described in (d), and

(d) properties described in any of (a) to (c).

For this purposes, a qualifying entity in respect of an individual is the individual, a spouse or common-law partner, child or parent of the individual, a partnership (an interest in which was an interest in a family fishing partnership of the individual or of a spouse or common-law partner, child or parent of the individual), a corporation or any other corporation (a share of the capital stock of which was a share of the capital stock of a family fishing corporation of the individual or of a spouse or common-law partner, child or parent of the individual) or another corporation controlled by that corporation.

Clause 11

***Inter vivos* transfer of farm property to child**

ITA
73(3)

Subsection 73(3) of the Act provides a tax-deferral for an *inter vivos* transfer of farm property by a taxpayer to a child of the taxpayer.

For dispositions made after December 20, 2002, paragraph 73(3)(*c*) is amended to clarify that subsection 73(3) does not apply if the anti-avoidance rule in subsection 69(11) of the Act applies. When applicable, subsection 69(11) denies the benefit of the rollover by treating the vendor's proceeds of disposition to be equal to the fair market value of the transferred property notwithstanding any other provision of the Act.

***Inter vivos* transfer of farm or fishing property to child**

ITA
73(3) and (3.1)

New subsections 73(3) and (3.1) of the Act replace existing subsection 73(3) and provide a tax deferred rollover for capital gains and recaptured depreciation on *inter vivos* transfers of certain farm or fishing property, of a taxpayer, by the taxpayer to a child of the taxpayer.

New subsection 73(3) provides that a tax-deferral for an *inter vivos* transfer of certain fishing or farm property by a taxpayer to a child of the taxpayer is available under new subsection 73(3.1), where

- the property transferred was, immediately before the transfer, land, depreciable property of a prescribed class, or any eligible capital property in respect of a fishing or farming business carried on in Canada by the taxpayer,
- the child was, immediately before the transfer, resident in Canada, and
- the property has been used principally in a fishing or a farming business in which the taxpayer, the taxpayer's spouse or common-law partner, a child of the taxpayer, or parent of the taxpayer was actively engaged on a regular and continuous basis.

New subsection 73(3.1) provides the following:

- subsection 69(1) of the Act does not apply to the taxpayer and child in respect of the transfer of the property;
- where the property transferred was depreciable property of a prescribed class:
  - the taxpayer is deemed to have disposed of the property for proceeds of disposition equal to
    - if the proceeds of disposition otherwise determined exceeded the greater of the following two amounts, the greater of the following two amounts:
      - the fair market value of the property immediately before the time of the transfer, and
      - the lesser of,
        - the capital cost to the taxpayer of the property, and
        - the amount, determined immediately before the time of the disposition of the property, that is that proportion of the undepreciated capital cost of property of that class to the taxpayer that the capital cost to the taxpayer of the property is of the capital cost to the taxpayer of all property of that class that had not, at or before that time, been disposed of, or
    - if the proceeds of disposition otherwise determined were less than the lesser of those two amounts, the lesser of those two amounts, or
    - in any other case, the proceeds of disposition otherwise determined;
  - the child of the taxpayer is deemed to have acquired the depreciable property for an amount equal to the deemed proceeds of disposition to the taxpayer,
  - the capital cost to the child of the depreciable property is – for the purposes of sections 13 and 20 of the Act and any regulations made under paragraph 20(1)(*a*) of the Act – deemed to be the amount that was the capital cost of the depreciable property to the taxpayer and the amount, if any, by which capital cost to the taxpayer of the depreciable property exceeds the taxpayer's deemed proceeds of disposition of the depreciable property, is deemed to have been allowed to the child in respect of the depreciable property under the regulations made under paragraph 20(1)(*a*) in computing income for taxation years before the acquisition;
- where the property transferred was land,
  - the taxpayer is deemed to have disposed of the property for proceeds of disposition equal to
    - if the proceeds of disposition otherwise determined exceeded the greater of the following two amounts, the greater of the following two amounts:
      - the fair market value of the land immediately before the time of the transfer, and
      - the adjusted cost base to the taxpayer of the land immediately before the time of the transfer,
    - if the proceeds of disposition otherwise determined were less than the lesser of those two amounts, the lesser of those two amounts, or

    - in any other case, the proceeds of disposition otherwise determined;
  - the child of the taxpayer is deemed to have acquired the land for an amount equal to the deemed proceeds of disposition of the taxpayer determined in respect of the land;
- where the property transferred was eligible capital property, the taxpayer is deemed to have disposed of the property for proceeds of disposition equal to
  - if the proceeds of disposition otherwise determined exceeded the greater of the following two amounts, the greater of the following two amounts:
    - the fair market value of the property immediately before the time of the transfer, and
    - the amount determined by the formula

$$4/3 \times (A \times B/C)$$

    where

    A is the taxpayer's cumulative eligible capital in respect of the business,

    B is the fair market value of the property immediately before the transfer, and

    C is the fair market value immediately before that time of all eligible capital property of the taxpayer in respect of the business,
  - if the proceeds of disposition otherwise determined were less than the lesser of those two amounts, the lesser of those two amounts, or
  - in any other case, the proceeds of disposition otherwise determined.
- where the child does not continue to carry on the business, the child is deemed to have acquired a capital property, immediately after the transfer, at a cost equal to the deemed proceeds of disposition of the taxpayer in respect of the property,
- where the child continues to carry on the business, the child is deemed to have acquired an eligible capital property and to have made an eligible capital expenditure at a cost equal to the total of
  - that amount of the deemed proceeds of disposition of the taxpayer in respect of the property, and
  - 4/3 of the amount determined by the formula

$$(A \times B/C) - D$$

  where

  A is the amount, if any, determined for F in the definition "cumulative eligible capital" in subsection 14(5) of the Act in respect of the business of the taxpayer immediately before the time of the transfer,

  B is the fair market value of the eligible capital property immediately before that time,

  C is the fair market value immediately before that time of all eligible capital property of the taxpayer in respect of the business, and

  D is the amount, if any, included under paragraph 14(1)(*a*) in computing the income of the taxpayer as a result of the disposition of the eligible capital property, and
- for the purpose of determining at any subsequent time the child's cumulative eligible capital in respect of the business, an amount equal to ¾ of the amount determined by the above formula is to be added to the amount otherwise determined in respect thereof for element P in the definition "cumulative eligible capital" in subsection 14(5),

- in determining the amount deemed to be the child's taxable capital gain, and the amount to be included in computing the child's income, in respect of any disposition of property by the business, after the transfer, there shall be added to the amount otherwise determined for Q in respect of the business in the definition "cumulative eligible capital" in subsection 14(5), the amount determined by the formula

$$A \times B/C$$

where

A is the amount, if any, determined for element Q in that definition in respect of the business of the taxpayer immediately before the time of the transfer,

B is the fair market value, immediately before that time, of the property transferred, and

C is the fair market value, immediately before that time, of all eligible capital property of the taxpayer in respect of the business.

New subsections 73(3) and (3.1) generally apply to dispositions of property that occur on or after May 2, 2006.

***Inter vivos* transfer of family farm corporations and partnerships**

ITA
73(4)

Subsection 73(4) of the Act provides a tax-deferral for an *inter vivos* transfer of shares of a family farm corporation or an interest in a family farm partnership by a taxpayer to a child of the taxpayer.

For dispositions made after December 20, 2002, paragraph 73(4)(*b*) is amended to clarify that subsection 73(4) does not apply if the anti-avoidance rule in subsection 69(11) of the Act applies. When applicable, subsection 69(11) denies the benefit of the rollover by treating the vendor's proceeds of disposition to be equal to the fair market value of the transferred property notwithstanding any other provision of the Act.

***Inter vivos* transfer of family farm or fishing corporations and partnerships**

ITA
73(4) and (4.1)

New subsections 73(4) and (4.1) of the Act replace existing subsection 73(4) and provide a capital gains rollover for *inter vivos* transfers made by a taxpayer to a child of the taxpayer of shares of the capital stock of a family farm corporation, shares of the capital stock of a family fishing corporation, interests in a family farm partnership or interests in a family fishing partnership, of the taxpayer.

New subsection 73(4) provides that new subsection 73(4.1) will apply to a taxpayer and a child of the taxpayer in respect of property that has been transferred, at any time, to the child where

- the child was resident in Canada immediately before the transfer, and
- the property was, immediately before the transfer, a share of the capital stock of a family farm corporation of the taxpayer, a share of the capital stock of a family fishing corporation of the taxpayer, an interest in a family farm partnership of the taxpayer, or an interest in a family fishing partnership of the taxpayer (within the meaning assigned by subsection 70(10) of the Act).

New subsection 73(4.1) provides that:

- subsection 69(1) of the Act does not apply to the taxpayer and child in respect of the transfer of the property, and

- the taxpayer is deemed to have disposed of the property for proceeds of disposition equal to
  - if the proceeds of disposition otherwise determined exceed the greater of the following two amounts, the greater of the following two amounts:
    - the fair market value of the property immediately before the time of the transfer, and
    - the adjusted cost base to the taxpayer of the property immediately before the time of the transfer.
  - if the proceeds of disposition otherwise determined were less than the lesser of those two amounts, the lesser of those two amounts, or
  - in any other case, the proceeds of disposition of the taxpayer otherwise determined in respect of the property.
- where the property was, immediately before the transfer, a share of the capital stock of a family farm corporation or of a family fishing corporation, of the taxpayer, the child of the taxpayer is deemed to have acquired the property for an amount equal to the deemed proceeds of disposition of the taxpayer.
- where the property was, immediately before the transfer, an interest in a family farm partnership or an interest in a family fishing partnership:
  - the taxpayer is deemed not to have disposed of the property at the time of the transfer (except for the purposes of paragraph 98(5)(*g*) of the Act),
  - the child is deemed to have acquired the property at the time of the transfer at a cost equal to the cost to the taxpayer of the interest immediately before the transfer, and
  - each amount required to be added or deducted by subsection 53(1) or (2) of the Act in computing the adjusted cost base to the taxpayer, immediately before the transfer, of the property is deemed to be an amount required by subsection 53(1) or (2) to be added or deducted in computing, at any time at or after the time of the transfer, the adjusted cost base to the child of the property.

The rules would not apply where the rules in subsection 100(3) of the Act dealing with a transfer of a partnership interest on death apply.

New subsections 73(4) and (4.1) generally apply to dispositions of property that occur on or after May 2, 2006.

Clause 12

Transfers and loans to minors

ITA
74.1(2)

Subsection 74.1(2) of the Act provides income attribution rules with respect to loans and transfers of property by individuals to persons under 18 years of age. In such a case, any income or loss derived by the minor from the property while the individuals is a resident in Canada is included in computing the individual's income. These income attribution rules do not apply in respect of income arising from amounts received in respect of those minor persons as a consequence of the operation of subsection 122.61(1) (the Canada Child Tax Benefit).

Subsection 74.1(2) is amended to exclude from the application of these attribution rules, income arising from amounts received in respect of an eligible child under section 4 of the *Universal Child Care Benefit Act*.

This amendment applies in respect of amounts received after June 30, 2006.

Clause 13

Acquisition of certain tools – capital cost and deemed depreciation

ITA
85(5.1)

Subsection 85(5.1) of the Act provides special rules that apply to a transferee corporation that acquires tools in respect of which a deduction was claimed by an apprentice mechanic under paragraph 8(1)(*r*) of the Act. In general, and consequential to new paragraph 8(1)(*s*), subsection 85(5.1) is amended to apply to a transferee corporation that acquires tools in respect of which a deduction was claimed by a tradesperson under paragraph 8(1)(*s*).

This amendment applies to the 2006 and subsequent taxation years.

Clause 14

Acquisition of certain tools – capital cost and deemed depreciation

ITA
97(5)

Subsection 97(5) of the Act provides special rules that apply to a transferee partnership that acquires tools in respect of which a deduction was claimed by an apprentice mechanic under paragraph 8(1)(*r*) of the Act. In general, and consequential to new paragraph 8(1)(*s*), subsection 97(5) is amended to apply to a partnership that acquires tools in respect of which a deduction was claimed by a tradesperson under paragraph 8(1)(*s*).

This amendment applies to the 2006 and subsequent taxation years.

Clause 15

Beneficiary's taxable capital gain

ITA
104(21.2)(*b*)

Subsection 104(21.2) of the Act sets out the rules for allocating the net taxable capital gains of a personal trust to its beneficiaries for the purpose of section 110.6 of the Act.

Paragraph 104(21.2)(*b*) is amended to permit a trust to allocate to its beneficiaries, for the purposes of the lifetime capital gains exemption, its net taxable capital gains from the disposition of "qualified fishing property" (within the meaning assigned by subsection 110.6(1)) of the trust.

The amendment applies to dispositions of eligible property that occur on or after May 2, 2006.

Clause 16

Definitions

ITA
108(1)

Subsection 108(1) of the Act sets out certain definitions and rules that apply for the purposes of subdivision k. This subdivision deals with the taxation of trusts and their beneficiaries. The definition "qualified fishing property" is being added to this subsection.

"Qualified fishing property" of an individual is defined as having the meaning assigned by subsection 110.6(1) of the Act.

Clause 17

Definitions

ITA
110.6(1)

Subsection 110.6(1) of the Act sets out a number of definitions for the purposes of section 110.6 of the Act. That section provides the rules for the capital gains exemption.

The definitions "annual gains limit", "interest in a family farm partnership", "qualified farm property", and "share of the capital stock of a family farm corporation" are being amended.

As well, the definitions, "interest in a family fishing partnership", "qualified fishing property" and "share of the capital stock of a family fishing corporation" are being added to this subsection.

Except where specifically noted below, these newly added or amended definitions apply to taxation years that end on or after May 2, 2006.

"interest in a family farm partnership"

"Interest in a family farm partnership" of an individual (other than a trust that is not a personal trust) means a partnership interest owned by the individual in a partnership if two conditions are met.

The first condition is that, throughout any 24-month period before the disposition of the property, more than 50% of the fair market value of the property of the partnership was attributable to

(a) property that was used principally in the course of carrying on the business of farming in Canada where the business is carried on by a qualified entity in respect of the individual and the business is one in which at least one of the following persons was actively engaged on a regular and continuous basis:

- the individual,
- where the individual is a personal trust, a beneficiary of that trust, or
- a spouse or common-law partner, child or parent of the individual or of that beneficiary,

(b) shares or any indebtedness of one or more corporations all or substantially all of the fair market value of the property of which is attributable to properties described in (d),

(c) a partnership interest in or indebtedness of one or more partnerships all or substantially all of the fair market value of the property of which is attributable to properties described in (d), or

(d) properties described in (a) to (c).

For this purpose, a qualifying entity in respect of an individual is

- the individual,
- the partnership,
- where the individual is a personal trust, a beneficiary of the trust,
- a spouse or common-law partner, child or parent of the individual or of the beneficiary of that personal trust,
- a corporation, a share of the capital stock of which was a share of the capital stock of a family farm corporation of the individual, a beneficiary of the personal trust (where the individual is a personal trust), or a spouse or common-law partner, child or parent of the individual or of a beneficiary of that trust, or
- a partnership, a partnership interest of which was an interest in a family farm partnership of the individual, of a beneficiary of the personal trust (where the individual is a personal trust), or of a spouse or common-law partner, child or parent of the individual or of a beneficiary of that trust.

The second condition is that, at that time, all or substantially all of the fair market value of the property of the partnership was attributable to property described in (d) above.

An individual's "interest in a family farm partnership" constitutes qualified farm property of that individual and, as such, capital gains realized on the disposition of that interest will be eligible for the capital gains deduction under subsection 110.6(2).

"annual gains limit"

"Annual gains limit" of an individual for a taxation year is relevant in determining the individual's entitlement to the capital gains exemption for that year.

Paragraph (*b*) of the description of A in the formula used in the definition "annual gains limit" excludes gains and losses other than those arising on dispositions after 1984 of qualified farm properties and dispositions after June 17, 1987 of qualified small business corporation shares. That paragraph is amended to include gains and losses arising on dispositions of qualified fishing properties disposed of on or after May 2, 2006.

This amendment applies to dispositions of property that occur on or after May 2, 2006.

"share of the capital stock of a family farm corporation"

This definition is amended twice.

Firstly for dispositions of property that occur after 2001 and before May 2, 2006, subparagraph (*a*)(i) of the definition "share of the capital stock of a family farm corporation" in subsection 110.6(1) is amended to permit a corporation that is related to a particular family farm corporation to qualify as an eligible user of the property of the family farm corporation where shares of the related corporation, that are owned by the persons referred to in clauses (*a*)(i)(B) to (D) of the definition in respect of the particular family farm corporation, are shares of the capital stock of a family farm corporation of those persons.

Secondly, for dispositions of property that occur on or after May 2, 2006, "Share of the capital stock of a family farm corporation" of an individual (other than a trust that is not a personal trust) means a share of the capital stock of a corporation owned by the individual if two conditions are met.

The first condition is that, throughout any 24-month period ending before the time of disposition of the share by the individual, more than 50% of the fair market value of the property owned by the corporation was attributable to

(a) property that was used principally in the course of carrying on the business of farming in Canada where the business is carried on by a qualified entity in respect of the individual and the business is one in which at least one of the following persons was actively engaged on a regular and continuous basis:

- the individual,
- where the individual is a personal trust, a beneficiary of that trust, or
- a spouse or common-law partner, child or parent of the individual or of that beneficiary,

(b) shares or any indebtedness of one or more corporations all or substantially all of the fair market value of the property of which is attributable to properties described in (d),

(c) a partnership interest in or indebtedness of one or more partnerships all or substantially all of the fair market value of the property of which is attributable to properties described in (d), or

(d) properties described in (a) to (c).

For this purpose, a qualifying entity in respect of an individual is

- the individual,
- the corporation,

- where the individual is a personal trust, a beneficiary of the trust,
- a spouse or common-law partner, child or parent of the individual or of the beneficiary of that personal trust,
- another corporation that is related to the corporation and of which, a share of the capital stock was a share of the capital stock of a family farm corporation of the individual, of a beneficiary of the personal trust (where the individual is a personal trust) or of a spouse or common-law partner, child or parent of the individual or of such a beneficiary, or
- a partnership, an interest in which was an interest in a family farm partnership of the individual, of a beneficiary of the personal trust (where the individual is a personal trust) or of a spouse or common-law partner, child or parent of the individual or of such a beneficiary.

The second condition is that, at that time, all or substantially all of the fair market value of the property of the partnership was attributable to property described in (d) above.

An individual's share of the capital stock of a family farm corporation constitutes a qualified farm property of that individual and, as such, capital gains realized on the disposition of that share are eligible for the capital gains deduction provided under new subsection 110.6(2.2) of the Act.

"qualified farm property"

"Qualified farm property" of an individual (other than a trust that is not a personal trust) means a property owned by the individual, the spouse or common-law partner of the individual or a partnership, an interest in which is an interest in a family farm partnership of the individual or the individual's spouse or common-law partner that is

- real property that was used principally in the course of carrying on the business of farming by a qualified entity in respect of the individual,
- a share of the capital stock of a family farm corporation of the individual or the individual's spouse or common-law partner,
- an interest in a family farm partnership of the individual or the individual's spouse or common-law partner, or
- an eligible capital property used by a qualified entity in respect of the individual (or by a personal trust from which the individual acquired the property) in the course of carrying on the business of farming in Canada.

For this purpose, a qualified entity in respect of an individual is

(a) the individual,

(b) where the individual is a personal trust, a beneficiary of the trust that is entitled to receive directly from the trust any income or capital of the trust,

(c) a spouse or common-law partner, child or parent of the individual,

(d) a corporation, a share of the capital stock of which is a share of the capital stock of a family farm corporation of an individual referred to in any of (a) to (c), or

(e) a partnership, an interest in which is an interest in a family farm partnership of the individual, of a beneficiary of the trust that is entitled to receive directly from the trust any income or capital of the trust (where the individual is a personal trust), or of a spouse or common-law partner, child or parent of the individual or of the beneficiary.

"interest in a family fishing partnership"

"Interest in a family fishing partnership" of an individual (other than a trust that is not a personal trust) means a partnership interest owned by the individual in a partnership if two conditions are met.

The first condition is that, throughout any 24-month period before the disposition of the property, more than 50% of the fair market value of the property of the partnership was attributable to

(a) property that was used principally in the course of carrying on the business of fishing in Canada where the business is carried on by a qualified entity in respect of the individual and the business is one in which at least one of the following persons was actively engaged on a regular and continuous basis:

- the individual,
- where the individual is a personal trust, a beneficiary of that trust, or
- a spouse or common-law partner, child or parent of the individual or of that beneficiary,

(b) shares or any indebtedness of one or more corporations all or substantially all of the fair market value of the property of which is attributable to properties described in (d),

(c) a partnership interest in or indebtedness of one or more partnerships all or substantially all of the fair market value of the property of which is attributable to properties described in (d), or

(d) properties described in (a) to (c).

For this purpose, a qualifying entity in respect of an individual is

- the individual,
- the partnership,
- where the individual is a personal trust, a beneficiary of the trust,
- a spouse or common-law partner, child or parent of the individual or of the beneficiary of that personal trust,
- a corporation, a share of the capital stock of which was a share of the capital stock of a family fishing corporation of the individual, of a beneficiary of the personal trust (where the individual is a personal trust), or of a spouse or common-law partner, child or parent of the individual or of a beneficiary of that trust, or
- a partnership, a partnership interest of which was an interest in a family fishing partnership of the individual, of a beneficiary of the personal trust (where the individual is a personal trust), or of a spouse or common-law partner, child or parent of the individual or of a beneficiary of that trust.

The second condition is that, at that time, all or substantially all of the fair market value of the property of the partnership was attributable to property described in (d) above.

An individual's "interest in a family fishing partnership" constitutes qualified fishing property of that individual and, as such, capital gains realized on the disposition of that interest will be eligible for the capital gains deduction provided under new subsection 110.6(2.2) of the Act.

"qualified fishing property"

"Qualified fishing property" of an individual (other than a trust that is not a personal trust) means a property owned by the individual, the spouse or common-law partner of the individual or a partnership, an interest in which is an interest in a family fishing partnership of the individual or the individual's spouse or common-law partner that is

- real property or a fishing vessel that was used principally in the course of carrying on the business of fishing by a qualified entity in respect of the individual,
- a share of the capital stock of a family fishing corporation of the individual or the individual's spouse or common-law partner,
- an interest in a family fishing partnership of the individual or the individual's spouse or common-law partner, or
- an eligible capital property used by a qualified entity in respect of the individual (or by a personal trust from which the individual acquired the property) in the course of carrying on the business of fishing in Canada.

For this purpose, a qualified entity in respect of an individual means

(a) the individual,

(b) where the individual is a personal trust, a beneficiary of the trust that is entitled to receive directly from the trust any income or capital of the trust,

(c) a spouse or common-law partner, child or parent of the individual,

(d) a corporation, a share of the capital stock of which is a share of the capital stock of a family fishing corporation of an individual referred to in any of (a) to (c), or

(e) a partnership, an interest in which is an interest in a family fishing partnership of an individual referred to in any of (a) to (c).

"share of the capital stock of a family fishing corporation"

"Share of the capital stock of a family fishing corporation" of an individual (other than a trust that is not a personal trust) means a share of the capital stock of a corporation owned by the individual if two conditions are met.

The first condition is that, throughout any 24-month period ending before the time of disposition of the share by the individual, more than 50% of the fair market value of the property owned by the corporation was attributable to

(a) property that was used principally in the course of carrying on the business of fishing in Canada where the business is carried on by a qualified entity in respect of the individual and the business is one in which at least one of the following persons was actively engaged on a regular and continuous basis;

- the individual,
- where the individual is a personal trust, a beneficiary of that trust, or
- a spouse or common-law partner, child or parent of the individual or of that beneficiary,

(b) shares or any indebtedness of one or more corporations all or substantially all of the fair market value of the property of which is attributable to properties described in (d),

(c) a partnership interest in or indebtedness of one or more partnerships all or substantially all of the fair market value of the property of which is attributable to properties described in (d), or

(d) properties described in (a) to (c).

For this purpose, a qualifying entity means

- the individual,
- the corporation,
- where the individual is a personal trust, a beneficiary of the trust,
- a spouse or common-law partner, child or parent of the individual or of the beneficiary of that personal trust,
- another corporation that is related to the corporation and of which, a share of the capital stock was a share of the capital stock of a family fishing corporation of the individual, of a beneficiary of the personal trust (where the individual is a personal trust) or of a spouse or common-law partner, child or parent of the individual or of such a beneficiary, or
- a partnership, an interest in which was an interest in a family fishing partnership of the individual, of a beneficiary of the personal trust (where the individual is a personal trust) or of a spouse or common-law partner, child or parent of the individual or of such a beneficiary.

The second condition is that, at that time, all or substantially all of the fair market value of the property of the corporation was attributable to property described (d) above.

An individual's share of the capital stock of a family fishing corporation constitutes a qualified fishing property of that individual and, as such, capital gains realized on the disposition of that share will be eligible for the capital gains deduction provided under new subsection 110.6(2.2) of the Act.

Property used in a fishing business

ITA
110.6(1.2)

New subsection 110.6(1.2) of the Act is added to provide that, for the purposes of the new definition "qualifying fishing property" in subsection 110.6(1) of an individual, at any time, a property owned by the individual, the spouse or common-law partner of the individual, or a partnership, an interest in which is an interest in a family fishing partnership of the individual or of the individual's spouse or common-law partner, will not be considered to have been property used in the course of carrying on the business of fishing in Canada unless two conditions are met.

The first condition is that, throughout the period of at least 24 months immediately preceding that time, the property or property for which the property was substituted ("the property") was owned by one or more specified entities.

The second condition is that either

- in at least 2 years while the property was owned by one or more persons who are specified entities,
  - the property was principally used in a fishing business carried on in Canada in which an individual who is a specified entity, or where the individual is personal trust, the beneficiary of that trust, was actively engaged on a regular and continuous basis, and
  - the gross revenue of a person (the "operator") who is a specified entity from such a fishing business for the period the property was owned by a specified entity exceeded the income of that operator from all other sources for the period, or

- throughout a period of at least 24 months while the property was owned by one or more persons or partnerships that are specified entities, the property was used in a fishing business, in which an individual referred to in any of subparagraphs (*a*)(i) to (iii) in the definition "qualified fishing property", was actively engaged on a regular and continuous basis, by a
  - partnership referred to in subparagraph (*a*)(iv) in the definition "qualified fishing property", or
  - corporation referred to in subparagraph (*a*)(v) in the definition "qualified fishing property".

For this purpose, a specified entity means

- the individual, or a spouse or common-law partner, child or parent of the individual,
- a partnership, an interest in which is an interest in a family fishing partnership of the individual or of the individual's spouse or common-law partner,
- where the individual is a personal trust, the individual from whom the trust acquired the property or a spouse or common-law partner, child or parent of that individual, or
- a personal trust from which the individual or a child or parent of the individual acquired the property.

New subsection 110.6(1.2) generally applies to dispositions of property that occur on or after May 2, 2006.

Property used in a farming business

ITA
110.6(1.3)

New subsection 110.6(1.3) of the Act is added to provide that, for the purposes of amended definition "qualified farm property" in subsection 110.6(1) of an individual, at any time, a property owned by the individual, the spouse or common-law partner of the individual, or a partnership, an interest in which is an interest in a family farm partnership of the individual or of the individual's spouse or common-law partner, will not be considered property to have been used in the course of carrying on the business of farming in Canada unless two conditions are met.

The first condition is that, throughout the period of at least 24 months immediately preceding that time, the property or property for which the property was substituted ("the property") was owned by one or more specified entities.

Subject to new paragraph 110.6(1.3)(*c*) discussed below, the second condition is that either

- in at least 2 years while the property was owned by one or more persons who are specified entities,
  - the property was principally used in a farming business carried on in Canada in which an individual who is a specified entity, or where the individual is a personal trust, the beneficiary of that trust, was actively engaged on a regular and continuous basis, and
  - the gross revenue of a person (the "operator") who is a specified entity from such a farming business for the period the property was owned by the specified entity exceeded the income of that operator from all other sources for that period, or
- throughout a period of at least 24 months while the property was owned by one or more persons or partnerships that are specified entities, the property was used in a farming business, in which an individual referred to in any of subparagraph (*a*)(i) to (iii) in the definition "qualified farm property" was actively engaged on a regular and continuous basis, by a
  - partnership referred to in subparagraph (*a*)(iv) in the definition "qualified farm property", or
  - a corporation referred to in subparagraph (*a*)(v) in the definition "qualified farm property".

For this purpose, a specified entity means

- the individual, or a spouse or common-law partner, child or parent of the individual,
- a partnership, an interest in which is an interest in a family farming partnership of the individual or of the individual's spouse or common-law partner,
- where the individual is a personal trust, the individual from whom the trust acquired the property or a spouse or common-law partner, child or parent of that individual, or
- a personal trust from which the individual or a child or parent of the individual acquired the property.

New paragraph 110.6(1.3)(*c*) provides for a modified version of the second condition that applies in circumstances where the property or property for which the property was substituted was last acquired by the individual or partnership before June 18, 1987 (or after June 17, 1987 under an agreement in writing entered into before that date). This provision reflects the conditions that were in subparagraph (*a*)(vii) of the definition "qualified farm property" in subsection 110.6(1) (read without reference to these proposals).

New subsection 110.6(1.3) generally applies to dispositions of property that occur on or after May 2, 2006.

Capital gains deduction – qualified farm property

ITA
110.6(2)(*a*)

Under paragraph 110.6(2)(*a*) of the Act, each individual taxpayer is entitled to an exemption from tax on up to $250,000 of net taxable capital gains ($500,000 of capital gains) on certain eligible properties during his or her lifetime. The amount of the exemption has varied over the years to reflect changes in the inclusion rate in determining taxable capital gains. Transitional rules are provided to adjust for exemptions claimed in previous years to ensure that the remaining lifetime exemption always reflects the inclusion rate in effect for a particular taxation year. The descriptions of A to E in the formula in that paragraph effectively provide for these adjustments in respect of qualified farm property and qualified small business corporation shares.

The description of A in the formula is amended to provide, for greater certainty, that, when computing deductions from the $250,000 capital gains exemption, that description will also ensure that deductions are made in respect of amounts that had been deducted under section 110.6 in computing the individual's taxable income for a preceding taxation year that ended after October 17, 2000.

This amendment applies to preceding taxation years that end after October 17, 2000.

Capital gains deduction – qualified farm property

ITA
110.6(2)(*d*)

Subsection 110.6(2) of the Act provides for an individual's capital gains deduction for a taxation year in respect of qualified farm property. Paragraph 110.6(2)(*d*) provides that that deduction cannot exceed the amount that would be determined in respect of the individual for the year under paragraph 3(*b*) of the Act in respect of capital gains and capital losses if the only properties referred to in paragraph 3(*b*) were qualified farm properties disposed of after 1984. This limiting factor is necessary because both the "cumulative gains limit" and the "annual gains limit" include net taxable capital gains from the disposition of qualified small business corporation shares. Paragraph 110.6(2)(*d*) ensures that only net taxable capital gains from the disposition of qualified farm properties qualify for the full lifetime exemption limit under subsection 110.6(2).

As the definition "qualified small business corporation shares" has application only after June 17, 1987, paragraph 110.6(2)(*d*) is amended so that, for the purposes of applying subsection 110.6(2), the amount that would be determined for the taxation year in respect of the individual's properties under paragraph 3(*b*) in respect of capital gains and capital losses would only take into account dispositions of qualified farm properties that occur after June 17, 1987.

This amendment applies to taxation years that end on or after May 2, 2006.

Capital gains deduction – qualified small business shares

ITA
110.6(2.1)(*d*)

Subsection 110.6(2.1) of the Act provides for an individual's capital gains deduction for a taxation year in respect of qualified small business corporation shares. Paragraph 110.6(2.1)(*d*) provides that that deduction cannot exceed the amount that would be determined in respect of the individual for the year under paragraph 3(*b*) of the Act in respect of capital gains and capital losses if the only properties referred to in that paragraph were qualified small business corporation shares disposed of after June 17, 1987. However, paragraph 110.6(2.1)(*d*) provides that, in making that determining under paragraph 3(*b*), there shall not be included those amounts already included in the amount determined under paragraph (3)(*b*) for the purposes of paragraph 110.6(2)(*d*) in respect of the individual. This prevents potential double counting in cases where the qualified small business corporation shares are also qualified farm property.

Paragraph 110.6(2.1)(*d*) is amended consequential to the introduction of new subsection 110.6(2.2). New subsection 110.6(2.2) provides a deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified fishing property. The amendment to paragraph 110.6(2)(*d*) is intended to preclude any double counting where qualified small business corporation shares are also qualified fishing property.

This amendment applies to taxation years that end on or after May 2, 2006.

Capital gains deduction – qualified fishing property

ITA
110.6(2.2)

New subsection 110.6(2.2) of the Act is added to provide a deduction in computing the taxable income of an individual (other than a trust) in respect of taxable capital gains from the disposition of "qualified fishing property".

New subsection 110.6(2.2) provides that, where an individual who is resident in Canada throughout a taxation year has a taxable capital gain from a disposition of a qualified fishing property, the individual will be permitted to claim a deduction under section 110.6 in respect of that taxable capital gain in computing his or her taxable income for the year to the extent that he or she has not utilized his or her $500,000 lifetime capital gains exemption limit.

This amendment generally applies to taxation years that end on or after May 2, 2006.

Maximum capital gains deduction

ITA
110.6(4)

Subsection 110.6(4) of the Act provides an overall lifetime taxable capital gains exemption limit for an individual. The subsection adopts the limit provided for in paragraph 110.6(2)(*a*). As such, notwithstanding the amounts that may be computed as capital gains deductions under subsections 110.6(2) and (2.1), the individual is limited to an overall lifetime limit of $250,000 of deductions, in respect of taxable capital gains, as set out in paragraph 110.6(2)(*a*).

Consequential to the introduction of the capital gains deduction in respect of qualified fishing property in new subsection 110.6(2.2), subsection 110.6(4) is amended to ensure that an individual is limited to a total lifetime limit of $250,000 of deductions in respect of taxable capital gains derived from qualified farm property, qualified shares of a small business corporation, and qualified fishing property.

This amendment generally applies to taxation years that end on or after May 2, 2006.

Deemed resident in Canada

ITA
110.6(5)

Subsection 110.6(5) of the Act is a relieving provision that provides that, where an individual is resident in Canada at any time in a particular taxation year, the individual is deemed to be resident in Canada throughout that particular year if the individual was resident in Canada throughout either the immediately preceding taxation year or the immediately following taxation year. Subsection 110.6(5) is applicable only for the purposes of subsections 110.6(2), (2.1) and (3) and ensures that subsection 110.6(13) operates as intended to exclude, from the capital gains exemptions, amounts in respect of gains realized while the individual is a non-resident.

Subsection 110.6(5) is amended, consequential to the introduction of "qualified fishing property" in section 110.6, to apply also for the purposes of new subsection 110.6(2.2).

This amendment generally applies to taxation years that end on or after May 2, 2006.

Failure to report capital gain

ITA
110.6(6)

Subsection 110.6(6) of the Act denies a capital gains exemption for certain unreported net taxable capital gains. This subsection applies where an individual has realized a capital gain on a disposition of capital property in a taxation year and knowingly or under circumstances amounting to gross negligence fails to report the disposition in his or her return of income for that taxation year or fails to file a return for that taxation year within one year following the taxpayer's filing-due date for the taxation year.

Subsection 110.6(6) is amended consequential to the extension of the lifetime capital gains exemption to "qualified fishing property" in section 110.6.

This amendment generally applies to taxation years that end on or after May 2, 2006.

Deduction not permitted

ITA
110.6(7)

Subsection 110.6(7) of the Act is an anti-avoidance rule to prevent the conversion of taxable capital gains of corporations into exempt capital gains of individuals. Any such gains of an individual will be denied the capital gains exemption under subsections 110.6(2) and (2.1).

Subsection 110.6(7) is amended consequential to the extension of the lifetime capital gains exemption to "qualified fishing property" in section 110.6.

This amendment generally applies to taxation years that end on or after May 2, 2006.

Deduction not permitted

ITA
110.6(8)

Subsection 110.6(8) of the Act provides that an individual may not claim the capital gains exemption with respect to a capital gain realized on a disposition of property where it is reasonable to conclude that a significant portion of the capital gain is attributable to the fact that dividend payments on a share (other than a prescribed share) have either not been made or have been deferred.

Subsection 110.6(8) is amended consequential to the extension of the lifetime capital gains exemption to "qualified fishing property" in section 110.6.

This amendment generally applies to taxation years that end on or after May 2, 2006.

Trust deduction

ITA
110.6(12)(*b*)

Subsection 110.6(12) of the Act generally provides for a deduction, in computing the taxable income of a trust for the benefit of a spouse or common-law partner for the taxation year of the trust in which the spouse or common-law partner dies, of an amount equal to the lesser of the unused lifetime capital gains exemption limit of the deceased and the amount of the taxable gains of the trust determined under that subsection.

Subsection 110.6(12) is amended to permit the trust referred to in that subsection to claim a deduction under section 110.6 in respect of a qualified fishing property disposed of by it on or after May 2, 2006. This amendment is consequential to the extension of the lifetime capital gains exemption to "qualified fishing property" in section 110.6.

This amendment generally applies to taxation years that end on or after May 2, 2006.

Clause 18

Tax rates applicable to individuals

ITA
117(2)

Subsection 117(2) of the Act provides the marginal rates of federal personal income tax.

Paragraphs 117(2)(*c*) and (*d*), as enacted by subsection 58(3) of the *Budget Implementation Act, 2006*, chapter 4 of the Statutes of Canada, 2006, are amended to replace the references to the amount $118,825 with references to the amount $118,285.

This amendment corrects a typographical error and applies to the 2007 and subsequent taxation years.

Clause 19

Annual adjustment of deductions and other amounts

ITA
117.1(1)

Subsection 117.1(1) of the Act provides for the indexing of various amounts, including the amounts on which the personal tax credits are based. Subsection 117.1(1) is amended to apply to the reference to $1,000 in the formula in paragraph 8(1)(*s*) of the Act (the tradesperson tool deduction) and the reference to $1,000 in paragraph (*a*) of the description of B in subsection 118(10) of the Act (the Canada employment credit).

This amendment applies to the 2008 and subsequent taxation years.

Clause 20

Pension credit

ITA
118(3)

Subsection 118(3) of the Act provides for a non-refundable pension credit for all individuals who are in receipt of eligible pension income. This credit is calculated by reference to eligible pension income of up to $1,000 multiplied by the appropriate percentage for the year. The appropriate percentage is 15.25% for the 2006 taxation year and 15.5% for the 2007 and subsequent taxation years.

Subsection 118(3) is amended to increase the eligible pension income up to $2,000.

This amendment applies to the 2006 and subsequent taxation years.

Canada employment credit

ITA
118(10)

Section 118 of the Act is amended by adding new subsection 118(10) – the new Canada employment credit. New subsection 118(10) provides to an individual a non-refundable tax credit on up to $1,000 of employment income for a taxation year. The tax credit is calculated by reference to the lesser of $1000 ($250 for the 2006 taxation year) and the individual's income for the taxation year from all offices and employments without taking into account deductions allowed under section 8 of the Act multiplied by the appropriate percentage for that year. The appropriate percentage is 15.25% for the 2006 taxation year and 15.5% for the 2007 and subsequent taxation years.

This amendment applies to the 2006 and subsequent taxation years.

Clause 21

Transit pass tax credit

ITA
118.02

New section 118.02 of the Act provides to an individual a non-refundable tax credit in respect of the cost of eligible public transit passes attributable to the use, by the individual or a qualifying relation in respect of the individual, of public transit in a taxation year. The credit is calculated by reference to that cost multiplied by the appropriate percentage for that taxation year. The appropriate percentage is 15.25% for the 2006 taxation year and 15.5% for the 2007 and subsequent taxation years.

New section 118.02 applies to the 2006 and subsequent taxation years in respect of the use of public transit services after June 2006.

Definitions

ITA
118.02(1)

New subsection 118.02(1) of the Act sets out certain definitions and rules that apply for the purpose of the transit pass tax credit.

"eligible public transit pass"

"Eligible public transit pass" is a document issued by or on behalf of a qualified Canadian transit organization that identifies the right of an individual (the holder or owner of the document) to use public commuter transit services of that organization on an unlimited number of occasions and on any day during which the services are offered during an uninterrupted period of at least 28 days.

"public commuter transit services"

"Public commuter transit services" are services offered to the general public of transporting individuals from a place in Canada to another place in Canada and in respect of which it can reasonably be expected that those individuals would return daily to the place of their departure. Those services have to be offered ordinarily for a period of at least 5 days per week by means of a bus, ferry, subway, train, or tram.

"qualified Canadian transit organization"

"Qualified Canadian transit organization" is a person authorised under a law of Canada or of a province to carry on a business in Canada (through a permanent establishment in Canada, as defined in Regulation 8201) that is the provision of public commuter transit services.

"qualifying relation"

"Qualifying relation" of an individual for a taxation year is a person who is the individual's spouse or common-law partner at any time in the taxation year or a child of the individual who has not attained the age of 19 years during the taxation year.

Calculation of transit pass tax credit

ITA
118.02(2)

New subsection 118.02(2) of the Act provides for the calculation of the non-refundable transit pass tax credit for a taxation year. The credit is determined by applying the appropriate percentage for the taxation year to the amount by which the cost of eligible public transit passes attributable to public transit for the individual or a qualifying relation exceeds any reimbursements and other forms of assistance that any individual is or was entitled to receive in respect of the cost of eligible public transit pass (other than an amount that is included in computing that individual's income and that is not deductible in computing that individual's taxable income). The appropriate percentage is 15.25% for the 2006 taxation year and 15.5% for the 2007 and subsequent taxation years.

Apportionment of credit

ITA
118.02(3)

New subsection 118.02(3) of the Act provides that, where more than one individual is entitled to the transit pass tax credit in respect of an eligible public transit pass, the total amounts claimed by those individuals cannot exceed the maximum amount that would be allowed if only one individual were claiming the transit pass tax credit. If the individuals cannot agree as to what portion of the amount each can so deduct, the Minister of National Revenue may fix the portions.

Child fitness tax credit

ITA
118.03

New section 118.03 of the Act provides to an individual a non-refundable tax credit in respect of up to $500 of eligible fitness expenses paid in a taxation year in respect of each qualifying child of the individual. The credit is calculated by reference to the total of such costs multiplied by the appropriate percentage for that taxation year. The appropriate percentage is 15.25% for the 2006 taxation year and 15.5% for the 2007 and subsequent taxation years.

New section 118.03 applies to the 2007 and subsequent taxation years.

Definitions

ITA
118.03(1)

New subsection 118.03(1) of the Act sets out certain definitions and rules that apply for the purpose of the child fitness tax credit.

"eligible fitness expense"

"Eligible fitness expense" is a fee paid to a qualifying entity as a cost for the registration or for a membership of a qualifying child in a program of prescribed physical activity. Such cost includes the cost to the qualifying entity of the program in respect of its

- administration,
- instruction,
- rental of required facilities and
- uniforms and equipment that are not available to be acquired by a participant in the program for an amount less than its fair market value at the time it is acquired.

"qualifying child"

"Qualifying child" of an individual for a taxation year is a child of the individual who had not, before the taxation year, attained the age of 16 years.

"qualifying entity"

"Qualifying entity" is a person or partnership that offers one or more programs of prescribed physical activity.

Calculation of the fitness tax credit

ITA
118.03(2)

New subsection 118.03(2) of the Act provides for the calculation of the child fitness tax credit for a taxation year. The credit is determined, in respect of each qualifying child of an individual, by applying the appropriate percentage for the taxation year to the lesser of $500 and the amount obtained when reimbursements and other forms of assistance that any individual is or was entitled to receive in respect of an eligible fitness expense (other than an amount that is included in computing that individual's income and that is not deductible in computing that individual's taxable income) are subtracted from the amount of eligible fitness expenses incurred in respect of a qualifying child.

Apportionment of credit

ITA
118.03(3)

New subsection 118.03(3) of the Act provides that, where more than one individual is entitled to the child fitness tax credit in respect of a qualifying child (for example the individual and the individual's spouse or common-law partner), the total amounts claimed by those individuals cannot exceed the maximum amount that would be allowed if only one individual were claiming the child fitness tax credit. If the individuals cannot agree as to what portion of the expense each can claim, the Minister of National Revenue may fix the portions.

Clause 22

Credit for mental or physical impairment

ITA
118.3(1)(*b*)

Paragraphs 118.3(1)(*a*.1) to (*a*.3) of the Act provide various conditions that must be met to be eligible for the Disability Tax Credit. Paragraph (*a*.3) was added recently applicable to the 2005 and subsequent taxation years.

Subsection 118.3(1)(*b*) is amended consequential to the introduction of this new paragraph and applies to the 2005 and subsequent taxation years.

Clause 23

Textbook tax credit

ITA
118.6(2.1)

New subsection 118.6(2.1) of the Act provides to an individual a non-refundable tax credit in respect of textbooks for each month in a taxation year in which an individual was entitled to claim the education tax credit.

The textbook tax credit for a taxation year is equal to the product obtained when the appropriate percentage for the taxation year is multiplied by $65 for each month in the taxation year in which the individual was entitled to claim the education tax credit as a full-time student or $20 for each month in the taxation year in which the individual was entitled to claim the education tax credit as a part-time student. The appropriate percentage is 15.25% for the 2006 taxation year and 15.5% for the 2007 and subsequent taxation years.

New subsection 118.6(2.1) applies to the 2006 and subsequent taxation years.

Students eligible for the disability tax credit

ITA
118.6(3)

Subsection 118.6(2) of the Act provides for an education tax credit of $400 for each month in the taxation year in which an individual is enrolled on a full-time basis in a qualifying educational program at a designated educational institution and of $120 for each month in the taxation year in which an individual is enrolled on a part-time basis in a specified educational program at a designated educational institution.

Subsection 118.6(3) extends full-time student eligibility for the education tax credit to certain part-time students, where the student is eligible for the disability tax credit or cannot be enrolled on a full-time basis because of the student's mental or physical impairment. Subsection 118.6(3) is amended to add a reference to subsection 118.6(2.1), in order that this provision may also apply for the purposes of the new textbook tax credit.

This amendment is consequential to the introduction of the new textbook tax credit in subsection 118.6(2.1) and applies to the 2006 and subsequent taxation years.

ITA
118.6(3)(*b*)(iii)

Subparagraph 118.6(3)(*b*)(iii) (subparagraph 118.6(3)(*b*)(iv) in the French version of the Act) is amended consequential to the amendment to paragraph 118.3(1)(*a*.2) of the Act which makes a physiotherapist eligible to certify, after February 22, 2005, a severe and prolonged impairment in walking.

This amendment applies to the 2005 and subsequent taxation years in respect of certifications made by a physiotherapist after February 22, 2005.

ITA
118.6(3)(*b*)(iv)

Subparagraph 118.6(3)(*b*)(iv) (subparagraph 118.6(3)(*b*)(v) in the French version of the Act) is amended consequential to the amendment to subparagraph 118.4(1)(*c*)(i) of the Act and the introduction of new subparagraph 118.4(1)(*c.1*) which was added, for greater certainty, to define mental functions necessary for everyday life.

This amendment applies to the 2005 and subsequent taxation years.

Clause 24

Unused tuition and education tax credits

ITA
118.61(1)

Subsection 118.61(1) of the Act provides for the calculation of a student's unused tuition and education tax credits that may be carried forward to future taxation years. This subsection is amended consequential to the introduction of the new textbook tax credit in subsection 118.6(2.1) of the Act. Variable A is amended, also consequential to the introduction of this new tax credit, to ensure a seamless carry-forward of amounts even when the name of the credit changes (i.e. from "the unused tuition and education tax credits" to "the unused tuition, textbook and education tax credits"). Variable C is amended as a consequence of the introduction of section 118.02 of the Act (the new transit pass tax credit).

These amendments apply to the 2006 and subsequent taxation years.

ITA
118.61(2)(*a*) and (*b*)

Subsection 118.61(2) of the Act determines the amount of the carry-forward of unused tuition and education tax credits that is deductible for the current year. Paragraph 118.61(2)(*a*) is amended consequential to the introduction of subsection 118.6(2.1) of the Act (the new textbook tax credit). Paragraph 118.61(2)(*b*) is amended as a consequence of the introduction of section 118.02 (the new transit pass tax credit) of the Act.

These amendments apply to the 2006 and subsequent taxation years.

ITA
118.61(3)

Subsection 118.61(3) of the Act is a transitional rule that applied on the reduction in 2001 of the lowest personal income tax rate from 17% to 16%. This subsection is repealed, as it no longer has any effect.

Change of appropriate percentage

ITA
118.61(4)

Subsection 118.61(4) of the Act adjusts the unused tuition and education tax credit at the end of the immediately preceding taxation year in circumstances where the "appropriate percentage" applicable in the current taxation year is different from the "appropriate percentage" applicable in the immediately preceding taxation year. Subsection 118.61(4) is amended to add references to subsection 118.6(2.1) of the Act (the new textbook tax credit).

This amendment applies to the 2005 and subsequent taxation years except that, for the 2005 and 2006 taxation years, the references to "the unused tuition, textbook and education tax credits" are to be read as references to "the unused tuition and education tax credits".

Clause 25

Transfer of unused credits to spouse or common-law partner

ITA
118.8

Section 118.8 of the Act governs the transfer to a spouse or common-law partner of certain unused personal tax credits. The credits that may be transferred are the tuition and education tax credits and the age, pension and disability tax credits. The description of variable A is amended to add a reference to the new textbook credit (subsection 118.6(2.1) of the Act) consequential to the introduction of this new tax credit. Subparagraph (*b*)(ii) of the description of variable C is amended to add a reference to section 118.01 of the Act (the adoption tax credit) and section 118.02 of the Act (the new transit pass tax credit).

These amendments apply to the 2005 and subsequent taxation years except that, in its application to the 2005 taxation year, subparagraph (*b*)(ii) of the description of variable C is to be read without its reference to section 118.02.

Clause 26

Tuition and education tax credits transferred

ITA
118.81

Section 118.81 of the Act provides for the calculation of the tuition and education tax credits that may be transferred under section 118.8 of the Act to the student's spouse or common-law partner, or under section 118.9 of the Act to a parent or grandparent.

The preamble of this section is amended to add a reference to subsection 118.6(2.1) of the Act (the new textbook credit). The description of variable B in paragraph 118.81(*a*) is amended to add a reference to sections 118.02 of the Act (the new transit pass tax credit).

These amendments apply to the 2006 and subsequent taxation years.

Clause 27

Transfer to parent or grandparent

ITA
118.9

Section 118.9 of the Act governs the transfer of a student's tuition and education tax credits to the student's parent or grandparents. Section 118.9 is amended to add a reference to subsection 118.6(2.1) of the Act (the new textbook tax credit).

This amendment applies to the 2006 and subsequent taxation years.

Clause 28

Part-year residents

ITA
118.91

Section 118.91 of the Act provides rules with respect to non-refundable tax credits allowed to individuals who reside in Canada for only part of a taxation year.

Subparagraph 118.91(*b*)(i) is amended to add a reference to subsection 118(10) of the Act (the new Canada employment credit) and section 118.02 of the Act (the new transit pass tax credit).

This amendment applies to the 2006 and subsequent taxation years.

Clause 29

Ordering of credits

ITA
118.92

Section 118.92 of the Act provides that the tax credits allowed in computing an individual's tax payable for a taxation year are to be applied in a specific order.

This section is amended to add a reference to subsection 118(10) of the Act (the new Canada employment credit) and section 118.02 of the Act (the new transit pass tax credit).

This amendment applies to the 2006 and subsequent taxation years.

Credits in separate returns

ITA
118.93

Section 118.93 of the Act provides that, where a separate return of income for an individual is filed under subsection 70(2), 104(23) or 150(4) of the Act for a period and another return under Part I is filed for a period ending in the calendar year in which the period covered in the separate return ends, the combined amounts deducted in respect of the credits in respect of pension income, charitable donations, medical expenses, impairments in mental or physical functions, tuition fees and education, and the transfer of unused credits to a supporting person, cannot exceed the amount that would be deductible under those provisions if no separate return were filed.

This section is amended to add a reference to subsection 118(10) of the Act – the new Canada employment credit.

This amendment applies to the 2006 and subsequent taxation years.

Tax payable by non-resident

ITA
118.94

Section 118.94 of the Act provides rules with respect to non-refundable tax credits allowed to individuals who did not reside in Canada at any time in a taxation year. Subject to the special rule in section 217 of the Act, such individuals are allowed to claim certain non-refundable credits for a taxation year only where all or substantially all (90%) of their income for the taxation year is included in computing their taxable income earned in Canada.

This section is amended to add a reference to section 118.02 (the new transit pass tax credit) of the Act and to subsection 118.6(2.1) of the Act (the new textbook credit).

This amendment applies to the 2006 and subsequent taxation years.

Clause 30

Credits in year of bankruptcy

ITA
118.95

When an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy; and a second that begins on the day of the bankruptcy and runs to December 31. Section 118.95 of the Act ensures that non-refundable tax credits that are based on expenditures or on the receipt of certain types of income are determined by reference to the amounts that relate to the relevant taxation year. In all cases, the total of the amounts claimed in respect of each of the credits for the two taxation years cannot be greater than the amount that could be claimed in respect of the calendar year as a whole.

The amendment to paragraph 118.95(*a*) adds a reference to subsection 118(10) of the Act (the new Canada employment credit) and section 118.02 of the Act (the new transit pass tax credit).

This amendment applies to the 2006 and subsequent taxation years.

Clause 31

Refundable medical expense supplement

ITA
122.51

Section 122.51 of the Act provides a refundable medical expense supplement equal to the lesser of $1,000 (indexed after 2006) and 25% of the total of allowable expenses claimed under the disability supports deduction and the medical expense tax credit by an eligible individual for the year. The supplement is reduced by 5% of "adjusted income" in excess of an indexed threshold.

The 25% factor is set out in subparagraph (*b*)(i) of the description of A in subsection 122.51(2), as a function of certain amounts creditable at 16%, the "appropriate percentage" before 2006. This factor is amended to achieve the 25% factor by reference instead to a defined term, the "appropriate percentage", used in computing the individual's non-refundable personal tax credits for the taxation year. The appropriate percentage is 15.25% for the 2006 taxation year and 15.5% for the 2007 and subsequent taxation years.

This amendment applies to the 2006 and subsequent taxation years.

Clause 32

Full rate taxable income

ITA
123.4(1)

Corporations are generally subject to tax under Part I of the Act at a rate of 38% (as specified in subsection 123(1) of the Act), less 10% of any taxable income earned in the year in a province (as specified in subsection 124(1) of the Act and generally called the "provincial abatement"). The resulting 28% is further reduced by the general rate reduction under subsection 123.4(2) of the Act, and the definition "full rate taxable income" is relevant in determining the amount of a corporation's general rate reduction.

A corporation's "full rate taxable income" for a taxation year is defined in subsection 123.4(1), and, in general terms, is that part of the corporation's taxable income for the year that has not benefited from any of the various special tax rates provided under the Act. This amount is determined differently depending on the status of the corporation. Paragraph (*a*) of the definition applies to corporations other than Canadian-controlled private

corporations (CCPCs) and various "specialty corporations" such as investment corporations and mutual fund corporations. Paragraph (*b*) applies to CCPCs. Investment corporations, mortgage investment corporations, mutual fund corporations and non-resident-owned investment corporations are dealt with in paragraph (*c*); their full rate taxable income is nil.

Paragraph (*a*) of the definition is amended to ensure that, if an amount of taxable income of a corporation is not subject to tax under subsection 123(1), that amount does not benefit from the general rate reduction in subsection 123.4(2).

This amendment to paragraph (*a*) of the definition applies to taxation years that begin on or after May 2, 2006.

Paragraph (*a*) of the definition is also amended consequential to the amendments that increase to 17% from 16% the tax credit for credit unions provided under subsection 137(3) of the Act (see commentary on that subsection). Subparagraph (*a*)(iv) of the definition currently excludes from full rate taxable income 100/16 of any amount deducted in respect of subsection 137(3). This subparagraph is amended to refer specifically to taxable income that benefits from this tax credit, rather than to, as it currently does, a fraction of the amount deducted in respect of subsection 137(3).

Amended subparagraph (*a*)(iv) of the definition applies to the 2008 and subsequent taxation years.

Paragraph (*b*) of the definition is amended consequential to the amendments that increase to 17% from 16% the small business deduction rate in section 125 of the Act (see commentary on subsections 125(1) and (1.1)). Subparagraph (*b*)(ii) of the definition currently excludes from full rate taxable income 100/16 of any amount deducted under subsection 125(1). This subparagraph is amended to refer specifically to taxable income that benefits from the small business deduction, rather than to a fraction of the amount deducted under subsection 125(1).

Amended subparagraph (*b*)(ii) of the definition applies to the 2008 and subsequent taxation years.

Clause 33

Small business deduction

ITA
125

Section 125 of the Act contains rules concerning the small business deduction that may be claimed by a Canadian-controlled private corporation in respect of its income from carrying on an active business in Canada.

ITA
125(1)

The small business deduction available to Canadian-controlled private corporations is provided for under subsection 125(1) of the Act by way of an annual tax credit not exceeding 16% of the least of certain amounts, one of which is the "business limit" (currently $300,000; see the commentary on subsections 125(2) and (3)).

Subsection 125(1) is amended by replacing the reference to a specific rate with a new term: "small business deduction rate" (as defined in new subsection 125(1.1)). As a result, a corporation's small business deduction for a taxation year will be the amount equal to the corporation's small business deduction rate for the year multiplied by the least of the amounts described in existing paragraphs 125(1)(*a*) to (*c*).

Amended subsection 125(1) applies to the 2008 and subsequent taxation years.

ITA
125(1.1)

For the purpose of computing the small business deduction under subsection 125(1) of the Act, a corporation's small business deduction rate for a taxation year is determined under new subsection 125(1.1). Under this provision, the current small business deduction rate of 16% (specified in existing subsection 125(1)) is increased over two taxation years to 17%: a half per cent increase for the 2008 taxation year; and another half per cent increase for the 2009 and subsequent taxation years. The small business deduction rate will be prorated for taxation years that overlap calendar years with different rates.

New subsection 125(1.1) applies to the 2008 and subsequent taxation years.

ITA
125(2) and (3)

The "business limit" of a Canadian-controlled private corporation (CCPC) is relevant in determining the CCPC's small business deduction under subsection 125(1) of the Act. A corporation's "business limit" for a taxation year is determined under subsection 125(2), in the case of a corporation that is not associated with any CCPCs in the year, or under subsection 125(3), in the case of a corporation that is associated with one or more Canadian-controlled private corporations in the year. Currently, $300,000 is the maximum "business limit" under these provisions.

Subsections 125(2) and (3) are amended by increasing the "business limit" to $400,000, effective for the 2007 and subsequent taxation years, except that the "business limit" will be prorated for 2007 and 2008 taxation years that begin before 2007.

ITA
125(7)

"specified partnership income"

Subsection 125(7) of the Act provides definitions for the terms used in section 125, relating to the "small business deduction" for Canadian-controlled private corporations (CCPCs). The "specified partnership income" of a corporation is defined in this provision by reference to a formula and is used in determining the small business deduction of a CCPC that carries on an active business through a specified partnership.

Consequential to the increase to $400,000 from $300,000 of the "business limit" (see commentary on subsection 125(2) and (3)), the description of M in the formula in the definition is amended by replacing the reference to "$300,000" with a reference to "$400,000" and the reference to "$822" with a reference to "$1,096".

These amendments to the definition apply to partnership fiscal periods that end after 2006.

Clause 34

Deductions from tax payable

ITA
127

Section 127 of the Act permits deductions in computing taxable income in respect of logging, political contributions and investment tax credits.

Investment tax credit

ITA
127(5)

Subsection 127(5) of the Act provides for the deduction of investment tax credits (ITCs) from a taxpayer's Part I tax otherwise payable.

Subsection 127(5) is amended consequential to the introduction of the Apprenticeship Job Creation Tax Credit, which is earned in respect of eligible salary and wages payable to an eligible apprentice by a taxpayer that carries on business in Canada. For further information, see the commentary below accompanying subsections 127(8.1) to (8.31) and the new definitions "apprenticeship expenditure", "eligible apprentice" and "eligible salary and wages", and new paragraph (*a.4*) to the definition "investment tax credit", in subsection 127(9).

This amendment applies to taxation years that end on or after May 2, 2006.

Investment tax credit of testamentary trust

ITA
127(7)

Subsection 127(7) of the Act permits a testamentary trust and a communal organization treated as an *inter vivos* trust under section 143 of the Act to allocate its investment tax credits (ITCs) to its beneficiaries. Subsection 127(7) is amended to add a reference to new paragraph (*a.4*) of the definition "investment tax credit" in subsection 127(9) consequential to the new Apprenticeship Job Creation Tax Credit.

This amendment applies to taxation years that end on or after May 2, 2006.

Investment tax credit of partnership

ITA
127(8)

Subsection 127(8) of the Act provides for the allocation of the investment tax credits (ITCs) earned by a partnership to its partners.

In general terms, subsection 127(8) allocates a portion of a partnership's ITCs to each partner based on what can reasonably be considered to be the particular partner's share of the ITCs.

Subsection 127(8) also provides that SR&ED ITCs cannot be allocated to a partner of a partnership that is at any time in the taxation year (fiscal period) of the partnership to which the credit relates to a "specified member" of the partnership. Generally, a specified member is a partner who is a limited partner or a passive general partner (see the definition "specified member" in subsection 248(1) of the Act).

Subsection 127(8) is amended to provide for an allocation of a partnership's apprenticeship expenditure ITCs (i.e., in respect of eligible salary and wages payable to an eligible apprentice by the partnership). For further information, see the commentary below accompanying subsections 127(8.1) to (8.31) and subsection 127(9).

This amendment applies to taxation years that end on or after May 2, 2006.

Investment tax credit of limited partner

ITA
127(8.1)

Subsection 127(8.1) of the Act restricts the amount of investment tax credits (ITCs) that may be allocated by a partnership to a limited partner. In general terms, a limited partner can be allocated the limited partner's share of non-SR&ED ITCs only to the extent the allocation is not constrained by the limited partner's expenditure base and at-risk amount in respect of the partnership.

Subsection 127(8.1) is amended to extend its application to apprenticeship expenditure ITCs (i.e., in respect of eligible salary and wages payable to an eligible apprentice by the partnership). For further information, see the commentary below accompanying subsections 127(8.2) to (8.31) and subsection 127(9).

This amendment applies to taxation years that end on or after May 2, 2006.

Investment tax credit – expenditure base

ITA
127(8.2)(*b*)

Subsection 127(8.2) of the Act defines, for the purpose of the rules in subsection 127(8.1), a limited partner's expenditure base for a taxation year of a partnership (its fiscal period).

Paragraph 127(8.2)(*b*) ensures that in no event can a limited partner's expenditure base exceed his or her proportionate share of the aggregate expenditure base of all limited partner's of the partnership.

Paragraph 127(8.2)(*b*) is amended – consequential to the introduction of the apprenticeship expenditure ITC – to ensure that apprenticeship expenditures incurred by a partnership in a taxation year (its fiscal period) are taken into account in determining a limited partner's expenditure base.

This amendment applies to taxation years that end on or after May 2, 2006.

Investment tax credit – allocation of unallocated partnership ITCs

ITA
127(8.3) and (8.31)

Subsection 127(8.3) of the Act provides rules for allocating to certain partners a portion of any partnership investment tax credits (ITCs) that remain after the allocations provided for under subsections 127(8) and (8.1). In general, ITCs that could remain for allocation after the application of those subsections would be SR&ED ITCs (which cannot be allocated to a specified member of the partnership) and other ITCs that cannot be allocated to a limited partner because they would exceed the lesser of the limited partner's expenditure base and at-risk amount.

Subsection 127(8.3) is amended to provide for an allocation of apprenticeship expenditure ITCs that cannot be allocated to a limited partner of the partnership because of subsection 127(8.1). In addition, subsection 127(8.3) is reworded and separated into two subsections.

New subsection 127(8.3) provides for the allocation of a portion of the unallocated partnership ITCs to members of the partnership who are not specified members of the partnership. The amount available for such an allocation is determined under new subsection 127(8.31).

The amount determined under new subsection 127(8.31) is the amount, if any, by which

- the partnership's total ITCs for its fiscal period

exceeds the total of

- the partnership ITCs allocated to general partners who are not specified members,
- the amount of non-SR&ED ITCs allocated to specified members of the partnership. This amount does not include SR&ED ITCs because such amounts cannot be allocated to specified members. In addition, this amount does not include other ITCs (e.g., apprenticeship expenditure ITCs) that cannot be allocated to limited partners because of the constraint in subsection 127(8.1), and

- the amount, if any, by which
    - (in general terms) the partnership's ITCs that would have been allocated to specified members of the partnership if they could have been allocated SR&ED ITCs and other ITCs under subsection (8), were they not constrained by subsection (8.1) in respect of allocations to limited partners,

  exceeds

    - that amount of partnership ITCs that are actually allocated to specified members.

Essentially, partnership ITCs that cannot be allocated to specified members of a partnership may be added for the purpose of subsection 127(8) – to the investment tax credits allocated to members of the partnership and who were not specified members of the partnership at any time in its fiscal period. This additional allocation under subsection 127(8) is to be based on what is reasonable in the circumstances (having regard to the investment in the partnership, including debt obligations of the partnership, of each such member of the partnership).

The following provides an example.

Example

Facts:

- Three individuals are partners, one of whom is an active general partner, one of whom is a specified member who is not a limited partner, and one of whom is a specified member who is a limited partner.
- The partnership agreement provides that the members share in the profits (losses) in proportion to their capital contributions.
- Each partner contributes $30,000 to the partnership, which also borrows $20,000. Thus, the partnership has $110,000 available to it. The partnership pays:
    - $20,000 of eligible salary and wages to an eligible apprentice in its fiscal period such that it earns a $2,000 Apprenticeship Job Creation Tax Credit under the new regime for such credits in section 127;
    - $30,000 on qualified SR&ED expenditures that are eligible for a 20% SR&ED ITC under section 127; and
    - $60,000 on property that is "qualified property" for the purposes of the 10% Atlantic Canada ITC in section 127.
- The partnership therefore earns $2,000 of apprenticeship expenditure ITCs, $6,000 of SR&ED ITCs and $6,000 of Atlantic Canada ITCs. The total ITCs are $14,000.
- The limited partner's at-risk amount is Nil (which is less than the partner's expenditure base as determined in subsection 127(8.2)).

Application of Subsection 127(8) to 127(8.1)

Based on their respective contributions and the partnership agreement, each partner would be allocated 1/3 of the $14,000 of partnership ITCs.

However, subsection 127(8) precludes an allocation of any portion of the $6,000 of SR&ED ITCs if it is to a specified member of the partnership – in this example, there are two such members (i.e., the passive general partner and the limited partner).

Allocation of ITCs:	SR&ED	Apprenticeship	ACITC
Active General Partner:	$2,000	$667 (rounded)	$2,000
Specified Member (G):	Nil/$2,000*	$667	$2,000
Specified Member (LP):	Nil/$2,000*	Nil/$667*	Nil/$2,000*

* In addition, however, subsection 127(8.1) reduces a limited partner's ITCs to that partner's at-risk amount, which is Nil.

Consequently, $6,667 of partnership ITCs are unallocated to partners: $4,000 of SR&ED ITCs; $667 of apprenticeship expenditure ITCs and $2,000 of Atlantic Canada ITCs.

However, subsections 127(8.3) and (8.31) can apply to allocate the unallocated ITCs to members of the partnership who are not specified members.

Application of subsections 127(8.3) and (8.31)

Subsection 127(8.3) allows non-specified partners of the partnership to add – for the purposes of subsection 127(8) – an additional amount in respect of the unallocated partnership ITCs to their respective ITCs as determined under subsection 127(8). The additional amount is the portion – based on what is reasonable in the circumstances having regard to each such non-specified member's investment in the partnership including debts of the partnership – of the amount of unallocated ITCs as determined under subsection 127(8.31).

In this example, there is only one non-specified member of the partnership. Thus, the sole non-specified member of the partnership may be allocated 100% of the unallocated ITCs.

If allocated, the non-specified member of the partnership can add the following amounts to that member's ITC determined under subsection 127(8) in computing that member's ITCs at the end of that member's taxation year:

Allocation of ITCs:	SR&ED	Apprenticeship	ACITC
Non-specified member:			
Subsection 127(8)	$2,000	$667 (rounded)	$2,000
Add:			
Subsection 127(8)/127(8.3)	$4,000	$667 (rounded)	$2,000
	$6,000	$1,334	$4,000

Note: subsection 127(8.4) provides that the partner who is entitled to an additional ITC because of subsection 127(8.3) may elect not to so add the amount to his or her ITCs, in which case the amount is not so allocated by the partnership.

The amendment to allow for the allocation of unallocated apprenticeship expenditure ITCs applies to taxation years that end on or after May 2, 2006 except that the rewording and separation of current subsection 127(8.3) into new subsections (8.3) and (8.31) does not apply to taxation years that end before 2007.

Definitions

ITA
127(9)

Subsection 127(9) of the Act provides for various definitions used in the provisions relating to investment tax credits (ITCs). For example, ITCs are available for most current and capital expenditures made on scientific research and experimental development (SR&ED) in Canada, and for the cost of "qualified property" under the Atlantic Canada ITC program.

Subsection 127(9) is amended in two respects.

First, the definition "investment tax credit" in subsection 127(9) is amended to add new paragraph (*a.4*) which refers to apprenticeship expenditures of a taxpayer for the taxation year in respect of an eligible apprentice.

Second, subsection 127(9) is amended to add in alphabetical order the following definitions that are related to the new ITC that is being extended to apprenticeship expenditures:

"apprenticeship expenditure"

"Apprenticeship expenditure" of a taxpayer for a taxation year in respect of an eligible apprentice is the lesser of:

- $2,000, and
- 10% of the eligible salary and wages payable by the taxpayer to an eligible apprentice in respect of the eligible apprentice's employment, in the taxation year and on or after May 2, 2006, by the taxpayer in a business carried on in Canada by the taxpayer in the taxation year.

"eligible apprentice"

"Eligible apprentice" means an individual who is employed in a prescribed trade in Canada during the first two years of the individual's apprenticeship contract, which contract is registered with Canada or a province or territory of Canada under an apprenticeship program designed to certify or license individuals in the trade.

"eligible salary and wages"

"Eligible salary and wages" of a taxpayer to an eligible apprentice means the amount, if any, that is the salary and wages payable by the taxpayer to the eligible apprentice in respect of the first 24 months of the apprenticeship (other than remuneration that is based on profits, bonuses, and amounts described in section 6 or 7 of the Act, and amounts deemed to be incurred by subsection 78(4) of the Act). Also see new subsection 127(11.4) of the Act for a special rule that can apply if more than one related employer in the same calendar year employs the eligible apprentice.

These amendments apply to taxation years that end on or after May 2, 2006.

Expenditure limit

ITA
127(10.2)

Subsection 127(10.1) of the Act allows a certain portion of a Canadian-controlled private corporation's (CCPC's) scientific research and experimental development (SR&ED) expenditures in a taxation year to be added in computing the CCPC's investment tax credit at the end of the year. The amount added is limited by reference to the CCPC's "expenditure limit" for the year, as determined under subsection 127(10.2).

The expenditure limit of a corporation for a particular taxation year is an amount from nil to $2 million, determined by a formula. The formula includes two variables: the taxable income of the corporation and its associated corporations, if any, for the preceding taxation year; and the total of the section 125 of the Act "business limits", for the particular year, of the corporation and any associated corporations. The effects of these variables are that a corporation's $2 million maximum expenditure limit decreases by $10 for each dollar of taxable income over $300,000 in the preceding taxation year, and that the resulting figure is further reduced in proportion to any reduction of the total "business limit" of the associated group.

The $300,000 threshold for reducing the expenditure limit is, in concept, linked to the maximum "business limit" under section 125, and subsection 127(10.2) is amended to reflect the increase in that limit to $400,000 from $300,000. As amended, the expenditure limit of a corporation for a taxation year will not decrease unless the corporation (together with associated corporations) has earned more than $400,000 of taxable income in the previous taxation year. The formula is also amended so that the expenditure limit continues to be reduced for CCPCs that have "business limits" less than the maximum under section 125.

More specifically, the formula in subsection 127(10.2) is currently ($5,000,000-10A) × B/C. Under the existing formula, A is the greater of $300,000 (the existing maximum "business limit") and the corporation's taxable income for the previous taxation year, or if the corporation is associated with other corporations, the total of the taxable incomes of each member of the group for its last taxation year that ended in the previous calendar year. B is the "business limit" of the corporation, or total "business limits" for the associated group, for the current taxation year. C is the corporation's maximum "business limit" for the year, calculated without applying subsection 125(5) (short taxation years) and (5.1) (reduction because of taxable capital in excess of $10 million), or the total of these amounts for a group of associated corporations.

Except in certain transitional cases described below, for the 2007 and subsequent taxation years the amended formula is ($6,000,000 – 10A) × B/C. A now represents the greater of $400,000 and the previous taxation year's taxable income amount. B and C are unchanged.

As noted above, amended subsection 127(10.2) generally applies to the 2007 and subsequent taxation years. However, if a 2007 or 2008 taxation year immediately follows a taxation year that ended before 2007, the formula's reference to "$6 million" is to be read as a reference to "$5 million", and the reference in the description of A to "$400,000" is to be read as a reference to "$300,000". This ensures that the expenditure limit is maintained at an appropriate level in those cases where the increased maximum "business limit" was not in place for the previous taxation year.

Investment tax credit

ITA
127(11.1)

Subsection 127(11.1) of the Act sets out various rules for determining amounts to be included in the investment tax credit calculation in subsection 127(9). The rules provide for a reduction of capital cost and qualified expenditures by certain amounts that qualify as assistance or contract payments.

Subsection 127(11.1) is amended to add new paragraph (*c.4*). Paragraph (*c.4*) provides that the amount of a taxpayer's apprenticeship expenditure for a taxation year is deemed to be the amount of the taxpayer's apprenticeship expenditure for the year otherwise determined less the amount of any government assistance or non-government assistance in respect of the expenditure for the year that, at the time of the filing of the taxpayer's return of income for the year, the taxpayer has received, is entitled to receive or can reasonably be expected to receive.

This amendment applies to taxation years that end on or after May 2, 2006.

Special rule for eligible salary and wages

ITA
127(11.4)

New subsection 127(11.4) of the Act provides a special rule that may apply for the purpose of the definition "eligible salary and wages" in subsection (9). Under this rule, a taxpayer's eligible salary and wages in respect of an eligible apprentice is considered to be nil if the apprentice is employed in a calendar year that includes the end of the taxpayer's taxation year by any other taxpayer who is related to the taxpayer (including a partnership that has a member that is related to the taxpayer). However, this is not the case if the taxpayer is designated in prescribed form by all of those related taxpayers to be the only employer of the eligible apprentice for the purpose of applying that definition to the salary and wages payable by the taxpayer to the eligible apprentice in the taxation year. In such circumstances, the designated taxpayer is the only taxpayer in the related group that may earn an apprenticeship expenditure ITC in respect of the apprentice.

This amendment applies to taxation years that end on or after May 2, 2006.

Clause 35

Basic minimum tax credit determined

ITA
127.531

Section 127.531 of the Act permits an individual to claim a deduction in computing minimum tax for most non-refundable personal tax credits.

Paragraph 127.531(*a*) is amended to add a reference to subsection 118(10) of the Act (the new Canada employment credit) and subsection 118.02(2) of the Act (the new transit pass tax credit).

This amendment applies to the 2006 and subsequent taxation years.

Clause 36

Where individual bankrupt

ITA
128(2)(*e*)

Subsection 128(2) of the Act contains a number of special rules that apply in cases of personal bankruptcy.

Paragraph 128(2)(*e*) requires a trustee in bankruptcy to file, for each taxation year in the calendar year in which an individual becomes bankrupt, an income tax return with respect to certain income of the estate and businesses of the individual. For this purpose, the individual's income is to be determined as if no deductions other than those specifically listed were available to the individual.

Paragraph 128(2)(*e*) is amended to add a reference to section 118.02 of the Act (the new transit pass tax credit).

This amendment applies to the 2006 and subsequent taxation years.

Clause 37

Credit unions

ITA
137(3)

Subsection 137(3) of the Act provides a special tax credit to enable credit unions to accumulate a reserve in respect of their members' deposits and share contributions. The tax credit is 16% of the amount, if any, described in subsection 137(3).

Consequential to the increase of the small business deduction rate to 17% from 16% (see commentary on section 125 of the Act), subsection 137(3) is amended by replacing the reference to a specific rate with a reference to the small business deduction rate defined in new subsection 125(1.1) (see commentary on that subsection). In effect, this amendment phases in over two taxation years (in tandem with the increase to the small business deduction rate) an increase to 17% of the tax credit provided under subsection 137(3).

Amended subsection 137(3) applies to the 2008 and subsequent taxation years.

Clause 38

Deposit insurance corporations

ITA
137.1(9)

Subsection 137.1(9) of the Act provides a special tax rate for deposit insurance corporations (DICs) other than those deemed by subsection 137.1(5.1) of the Act to be DICs and those incorporated under the *Canada Deposit Insurance Corporation Act*. The tax payable under Part I of the Act by a DIC for a taxation year is 22% of its taxable income for the taxation year.

Consequential amendments are made to subsection 137.1(9) as a result of the increase of the small business deduction rate to 17% from 16% (see commentary on section 125 of the Act). The tax payable by DICs under amended subsection 137.1(9) is expressed by reference to a formula, which effectively phases in over two taxation years (in tandem with the increase to the small business deduction rate) a decrease, to 21%, of the tax rate applicable under subsection 137.1(9).

Amended subsection 137.1(9) applies to the 2008 and subsequent taxation years.

Clause 39

Registered Pension Plans – Letter of credit

ITA
147.2(7)

The 2006 federal budget announced a number of temporary measures to provide funding relief for federally-regulated defined benefit registered pension plans (RPPs). One of the measures provides an extension of the existing five-year solvency funding payment period to 10 years on the condition that the difference between the five-year and 10-year level of payments is secured by a letter of credit. In the event of default, the financial institution that issued the letter of credit would be required to pay the face amount of the letter of credit to the RPP. Proposed regulations under the *Pension Benefits Standards Act, 1985* to implement these measures were pre-published in the Canada Gazette on June 10, 2006.

New subsection 147.2(7) of the Act provides a special rule of interpretation to ensure that the use of letters of credit as contemplated in the budget (or as permitted under provincial pension benefits legislation) will not give rise to any adverse tax implications.

Subsection 147.2(7) applies when there is a default or failure under the terms of a letter of credit issued in connection with an employer's funding obligations under a defined benefit provision of an RPP and, as a result, the issuer of the letter of credit pays an amount to the RPP. Subsection 147.2(7) treats the payment as though it had been made to the RPP by the employer, rather than the issuer, for purposes of section 147.2 and Part LXXXV of the *Income Tax Regulations*. This ensures, in particular, that the employer is entitled to a deduction under subsection 147.2(1) for the amount of the payment. It also ensures that the payment is a permissible contribution for purposes of the registration rule in paragraph 8502(*b*) of the Regulations and, therefore, does not jeopardize the registered status of the plan.

Subsection 147.2(7) applies only to the extent that the payment would have otherwise been an eligible contribution under subsection 147.2(2) if it had been made directly to the RPP by the employer.

This amendment applies after 2005.

Clause 40 to 42

Minimum tax on financial institutions

ITA
Part VI

Part VI of the Act contains the rules concerning the minimum tax on financial institutions, which is a tax on the amount by which a financial institution's taxable capital employed in Canada exceeds a certain threshold (called the capital deduction). Under the existing rules, the tax is effectively levied at a rate of 1.0% on taxable capital employed in Canada between $200 million and $300 million, and at a rate of 1.25% on taxable capital employed in Canada in excess of $300 million. The tax under Part VI is considered a minimum tax because the tax is, broadly speaking, reduced to the extent that the financial institution pays tax under Part I of the Act.

Amendments to Part VI increase the capital deduction to $1 billion from $200 million and introduce a single tax rate of 1.25% on taxable capital employed in Canada above that capital deduction, effective for taxation years that end on or after July 1, 2006. Special transitional rules apply for taxation years that straddle July 1, 2006 (see commentary to section 190.16 below).

Unused part I tax credits – transitional rule

ITA
190.1

Part VI of the Act contains the rules concerning the minimum tax on financial institutions, and section 190.1 of the Act establishes the rate of tax payable by a financial institution under Part VI. Subsections 190(1.1) and (1.2) relate to additional taxes under Part VI that are no longer imposed. Those subsections are repealed for taxation years that end on or after July 1, 2006.

Paragraph 190.1(3)(*b*) permits a financial institution to reduce its Part VI tax liability for a taxation year by the amount of any unused Part I tax credits for the seven preceding and three following taxation years. "Unused Part I tax credit" is defined in subsection 190.1(5) as generally the amount by which a financial institution's Part I tax payable for a taxation year exceeds its Part VI tax liability for the taxation year (before taking into account the deductions available under subsection 190.1(3)). The portion of subsection 190.1(3) after paragraph (*b*) relates to a pre-1992 system for offsetting these taxes; that portion is repealed for taxation years that end on or after July 1, 2006.

Subsection 190.1(4) sets out certain rules for the purposes of subsections 190.1(3), (5) and (6), including paragraph 190.1(3)(*b*). Subsection 190.1(4) is amended by adding a transitional rule – new paragraph (*c*), which restricts the ability of financial institutions to carry back unused Part I tax credits under paragraph 190.1(3)(*b*). Under new paragraph 190.1(4)(*c*), unused Part I tax credits of a corporation for taxation years ending on or after July 1, 2006 that are carried back under paragraph 190.1(3)(*b*) to taxation years ending before that time are computed as if the Part VI tax were still levied at a rate of 1.0% on taxable capital employed in Canada between $200 million and $300 million, and at a rate of 1.25% on taxable capital employed in Canada in excess of $300 million.

Capital deduction

ITA
190.15(1) to (3)

Part VI of the Act contains the rules concerning the minimum tax on financial institutions, which is a tax on the amount by which a financial institution's taxable capital employed in Canada exceeds a certain threshold (called the capital deduction).

Subsections 190.15(1) to (3) of the Act set out the rules for determining the capital deduction of a financial institution for a taxation year. Under the existing rules, the maximum capital deduction of a financial institution for a taxation year is the total of $200 million and an additional amount equal to the lesser of $20 million and 20% of the amount, if any, by which its taxable capital employed in Canada exceeds $200 million. This additional amount effectively reduces the Part VI tax rate of 1.25% (specified in subsection 190.1(1) of the Act) to 1.0% for taxable capital employed in Canada between $200 million and $300 million. (Taxable capital employed in Canada in excess of $300 million is subject to the 1.25% tax rate).

These subsections are amended by increasing the capital deduction to $1 billion, and by repealing the additional amount. In this way, there will be a single capital deduction of $1 billion under Part VI, and taxable capital employed in Canada exceeding that threshold will be subject to the Part VI tax rate of 1.25%.

These amendments apply to taxation years that end on or after July 1, 2006. Special transitional rules apply for taxation years that straddle July 1, 2006 (see commentary to section 190.16 below).

Transitional provisions

ITA
190.16

Amendments to the Part VI minimum tax on financial institutions increase the Part VI capital deduction to $1 billion from $200 million and introduce a single Part VI tax rate of 1.25% on taxable capital employed in Canada above that capital deduction, effective for taxation years that end on or after July 1, 2006 (see commentary on subsections 190.15(1) to (3)).

Transitional provisions are introduced for taxation years that begin before and end on or after July 1, 2006 (in this note called a "straddle year"). New subsection 190.16(1) of the Act prorates for a straddle year the tax payable by a financial institution under Part VI. For this purpose, new subsection 190.16(2) ensures that, if the financial institution is related to another financial institution at the end of the straddle year, a single allocation of the capital deduction under subsection 190.15(2) or (3) of the Act is used in computing the Part VI tax payable of the financial institution under new subsection 190.16(1).

New subsection 190.16(3) sets out a transitional rule for the purposes of applying subsection 190.15(5) to a financial institution for a straddle year. Subsection 190.15(5) provides rules for determining the capital deduction of a particular financial institution which has more than one taxation year ending in the same calendar year and is related in two or more of those taxation years to another financial institution that also has a taxation year ending in that calendar year. Where this occurs, the capital deduction of the particular financial institution for each taxation year at the end of which it is related to the other financial institution is equal to the amount allocated to it, under subsections 190.15(2) or (3), as its capital deduction for the first taxation year in that calendar year in which it is related to the other financial institution.

Where the "first such taxation year" described in subsection 190.15(5) is a straddle year, the capital deduction of the financial institution for that "first such taxation year" is prorated under new subsection 190.16(3). More specifically, the capital deduction of the financial institution for the straddle year is the total of: that proportion of the capital deduction allocated to the financial institution under subsection 190.16(1) that the number of days in the straddle year that precede July 1, 2006 is of the number of days in the straddle year; and that proportion of the capital deduction allocated to the financial institution under subsection 190.16(1) that the number of days in the straddle year that are on or after July 1, 2006 is of the number of days in the straddle year.

These transitional provisions apply to taxation years that end on or after July 1, 2006.

Part 2

Clause 43

Consequential amendment to subsection 15(1.1)

ITA
15(1.1)

Subsection 15(1) of the Act includes certain shareholder benefits in income. Paragraph 15(1)(b) excludes from that general rule the payment of a stock dividend. Subsection 15(1.1) of the Act provides that this exclusion will not apply where one of the purposes of the stock dividend payment is to significantly alter the value of the interest in the corporation of any specified shareholder of the corporation, unless the amount of the dividend has been included under paragraph 82(1)(*a*) of the Act in computing the income of the person who received the stock dividend.

Consequential to the changes to subsection 82(1) (see commentary on that subsection), subsection 15(1.1) is amended to refer to new paragraphs 82(1)(*a.1*), and (*c*) to (*e*), as well as to paragraph (*a*), effective for dividends paid after 2005.

Clause 44

Taxable dividends received

ITA
82(1)

Paragraph 82(1)(*a*) of the Act provides that taxable dividends received by a Canadian-resident individual shareholder from a corporation resident in Canada are included in computing the individual's income.

Paragraph (*b*) of that subsection also generally provides a 25% "gross-up" of the amount of those dividends described in subparagraph 82(1)(*a*)(ii), which is added in computing the income of an individual. Section 121 of the Act provides a dividend tax credit equal to 2/3 of the gross-up. Subsection 82(1) is amended to introduce a new gross-up of 45% in respect of eligible dividends received by a taxpayer.

Subsection 82(1) is also amended by moving the substance of existing subparagraph 82(1)(*a*)(i) into new paragraphs 82(1)(*c*) and (*d*), and the substance of subparagraph (*a*)(i.1) into new paragraph 82(1)(*e*).

Amended paragraph 82(1)(*a*) includes in income taxable dividends received by a taxpayer other than eligible dividends and amounts described in new paragraph (*c*), (*d*) or (*e*), and new paragraph (*a.1*) includes in income eligible dividends received by a taxpayer other than amounts described in new paragraph (*c*), (*d*) or (*e*). Subparagraph (i) in amended paragraph 82(1)(*b*) contains the existing gross-up of 25% applicable in respect of taxable dividends included in income under amended paragraph 82(1)(a). Subparagraph (ii) in amended paragraph 82(1)(*b*) provides for the new gross-up of 45% applicable in respect of eligible dividends included in income under new paragraph 82(1)(*a.1*).

These changes to subsection 82(1) apply to dividends paid after 2005.

Consequential amendment to subsection 82(3)

ITA
82(3)

Subsection 82(3) of the Act allows a taxpayer the option of including in his or her income amounts described in paragraph 82(1)(*a*) (generally, taxable dividends) received by a spouse or common-law partner. As a consequence to the changes to subsection 82(1) (see commentary on that subsection), subsection 82(3) is amended to allow taxpayers this same option in respect of eligible dividends referred to in new paragraph 82(1)(*a.1*), effective for amounts received or paid after 2005.

Clause 45

Consequential amendments to subsection 87(2)

ITA
87(2)

Subsection 87(2) of the Act contains rules that apply where two or more taxable Canadian corporations amalgamate to form a new corporation.

ITA
87(2)(*z.2*)

Paragraph 87(2)(*z.2*) of the Act is one of a number of rules in subsection 87(2) of the Act that apply where two or more taxable Canadian corporations amalgamate to form a new corporation. This paragraph ensures that the new corporation is treated as the same corporation as, and a continuation of, each predecessor for the purpose of the additional tax on excessive elections set out in Part III of the Act.

Paragraph 87(2)(*z.2*) is amended to apply also for the purposes of new Part III.1, which introduces an additional tax on excessive eligible dividend designations (see commentary on new Part III.1).

Amended paragraph 87(2)(*z.2*) applies to amalgamations that occur, and (via amended paragraph 88(1)(*e.2*) of the Act) to windings-up that begin, after 2005.

ITA
87(2)(*vv*) and (*ww*)

Where the new corporation is a Canadian-controlled private corporation or a deposit insurance corporation in its first taxation year, new paragraph 87(2)(*vv*) applies to ensure that the total of all the amounts determined in respect of the new corporation under new subsection 89(5) of the Act for its first taxation year (see commentary on that subsection) is added in computing the new corporation's general rate income pool at the end of that taxation year (see commentary for the new definition "general rate income pool" in subsection 89(1)).

Where the new corporation is neither a Canadian-controlled private corporation nor a deposit insurance corporation in its first taxation year, new paragraph 87(2)(*ww*) applies to ensure that the total of all the amounts determined in respect of the new corporation under new subsection 89(9) of the Act for its first taxation year (see commentary on that subsection) is added in computing the new corporation's low rate income pool at any time in that taxation year (see commentary for the new definition "low rate income pool" in subsection 89(1)).

New paragraphs 87(2)(*vv*) and (*ww*) apply to amalgamations that occur, and (via amended paragraph 88(1)(*e.2*) of the Act) to windings-up that begin, after 2005.

Clause 46

Consequential amendment to paragraph 88(1)(*e.2*)

ITA
88(1)(*e.2*)

Subsection 88(1) of the Act provides rules that apply where a subsidiary has been wound up into its parent corporation, if both corporations are taxable Canadian corporations and the parent owns at least 90% of the issued shares of each class of the subsidiary's capital stock.

Paragraph 88(1)(*e.2*) of the Act provides that a number of the rules that apply to amalgamations under subsection 87(2) of the Act also apply, with certain modifications, to windings-up under subsection 88(1). Consequential to the additions of new paragraphs 87(2)(*vv*) and (*ww*) (see commentary to subsection 87(2)), paragraph (*e.2*) is amended to ensure that the rules contained in those paragraphs apply to windings-up to which subsection 88(1) applies as if the references in those paragraphs to "subsection 89(5)" and "subsection 89(9)" were read as references to "subsection 89(6)" and "subsection 89(10)", respectively.

Amended paragraph 88(1)(*e.2*) applies to windings-up that begin after 2005.

Clause 47

Definitions

ITA
89(1)

Subsection 89(1) of the Act, which defines certain terms that apply to corporations and their shareholders, is amended by adding a number of new definitions.

"eligible dividend"

The new "eligible dividend" definition is most notably relevant for the purposes of the 45% "gross-up" in amended subsection 82(1) and the corresponding dividend tax credit of 11/18 in new paragraph 121(*b*) of the Act (see commentaries on subsection 82(1) and section 121).

An "eligible dividend" is a taxable dividend that is received by a person resident in Canada, paid after 2005 by a corporation resident in Canada and designated in the manner set out under new subsection 89(14) (see commentary on that subsection) to be an eligible dividend. Setting aside any election that may be made under new Part III.1 (see commentary on Part III.1, particularly with respect to new subsection 185.1(2)), this means that a taxable dividend that satisfies these requirements is an eligible dividend notwithstanding that the corporation in paying the dividend may have made an excessive eligible dividend designation (see commentary on the definition "excessive eligible dividend designation" in subsection 89(1)). That is, the designation by itself makes a taxable dividend an eligible dividend, but by the same token a taxable dividend is only an eligible dividend if is designated as such.

It is worth noting that because an eligible dividend must be a taxable dividend received by a person resident in Canada, capital dividends and capital gains dividends will in no case be eligible dividends: the definition "taxable dividend" in subsection 89(1) is defined to exclude capital dividends; and capital gains dividends are deemed by paragraph 130.1(4)(*b*) and 131(*b*), as the case may be, not to be amounts received as dividends. However, deemed dividends, such as those that are described under section 84 of the Act, can, if they otherwise satisfy the requirements set in the definition eligible definition and are designated by the corporation that is treated as having paid them, be eligible dividends.

It may be asked whether a dividend received by a beneficiary of a trust can qualify as an eligible dividend in the hands of the beneficiary. This is indeed the case. Specifically, subsection 104(19) of the Act provides that, if certain conditions are met, a portion of a taxable dividend received by a trust is deemed to be a taxable dividend received by the beneficiary of the trust from the corporation paying the dividend. If the conditions described above for a dividend to qualify as an eligible dividend are satisfied in respect of the taxable dividend in question, then that taxable dividend will be an eligible dividend in the hands of the beneficiary. A similar result is obtained in respect of a partnership; partners are generally considered to receive their pro rata share of eligible dividends paid to the partnership.

The new definition "eligible dividend" in subsection 89(1) applies in respect of taxation years that end after 2005.

"excessive eligible dividend designation"

The new definition "excessive eligible dividend designation" is principally relevant for the purposes of the additional tax on excessive eligible dividend designations in new Part III.1 of the Act (see commentary on that new part).

Whether a corporation has made an excessive eligible dividend designation in respect of an eligible dividend paid by it at any time in a taxation year will depend partly on whether the corporation is a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) and to what extent the corporation has a balance in its general rate income pool (GRIP) or low rate income pool (LRIP), as the case may be (see commentaries on the new definitions "general rate income pool" and "low rate income pool" in subsection 89(1)).

Unless paragraph (*c*) applies, paragraph (*a*) of the definition applies in respect of eligible dividends paid by CCPCs and DICs. The amount, if any, of an excessive eligible dividend designation made by a CCPC or DIC is determined by way of a formula, which can be described as having two parts: the first part, (A – B), identifies the amount, if any, by which the aggregate of all eligible dividends paid by the corporation in the taxation year exceeds the corporation's GRIP at the end of the year (or exceeds nil, if the corporation had a negative GRIP at the end of the year); and the second part, C/A, prorates the amount of any excess on an eligible dividend by eligible dividend basis.

As a result, the ability of CCPCs and DICs to pay eligible dividends in any given taxation year without making an excessive eligible dividend designation is limited under these rules to the extent that they have a GRIP at the end of the taxation year (and to the extent that paragraph (*c*) does not apply in respect of the eligible dividend). However, this also means that a CCPC or DIC can pay an eligible dividend at any particular time in a taxation year even if it has no balance in its GRIP at that time, provided the CCPC or DIC has a sufficient GRIP at the end of the year.

Examples

Situation: *A CCPC pays in the particular taxation year a $10,000 eligible dividend to each of its 20 Class A shareholders, for an aggregate amount of $200,000. At the end of the particular taxation year, the CCPC has a GRIP of $100,000.*

Result: *Setting aside any election that may be made under Part III.1, the CCPC paid $100,000 more in eligible dividends than it had in its GRIP at the end of the particular taxation year. As a result, the CCPC made an excessive eligible dividend designation of $5,000 in respect of each eligible dividend it paid in the particular taxation year.*

Situation: *On January 15, 2007, a CCPC pays a $5,000 eligible dividend to each of its four Class C shareholders, for an aggregate amount of $20,000. The CCPC had a GRIP of nil at the end of its 2006 taxation year, and all of its business income for its 2007 taxation year was eligible for the small business deduction in subsection 125(1) of the Act. The CCPC did however receive, immediately prior to its December 31st, 2007 taxation year end, a $20,000 eligible dividend from a public corporation for which it claimed a deduction from income in computing its taxable income. At the end of its 2007 taxation year, the CCPC therefore had a $20,000 GRIP.*

Result: *The CCPC – even though it paid the eligible dividend of $20,000 at a time in its 2007 taxation year when it had no amounts to include in its GRIP – made no excessive eligible dividend designation in respect of the $20,000 eligible dividend it paid, because it had a GRIP balance of $20,000 at the end of that taxation year.*

Unless paragraph (*c*) applies, paragraph (*b*) of the definition applies in respect of eligible dividends paid by corporations other than corporations described in paragraph (*a*). Paragraph (*b*) thus applies to public corporations, among others. Although the amount of an excessive eligible dividend designation is determined under this paragraph in a manner similar to paragraph (*a*) – by way of a formula that may be described as having two parts comparable to those described in respect of paragraph (*a*), two distinctions bear noting to illustrate the intended operation of paragraph (*b*): first, a corporation's LRIP is calculated at any time in a corporation's taxation year whereas a corporation's GRIP is calculated at the end of the taxation year (see commentaries to the new definitions "low rate income pool" and "general rate income pool" in subsection 89(1)); and the formula in paragraph (*b*), unlike paragraph (*a*), effectively introduces an ordering rule by requiring corporations, in order to avoid the additional tax on excessive eligible dividend designations (see commentary on new Part III.1), to first pay taxable dividends other than eligible dividends to the extent of its LRIP at the time it pays the dividends.

This also means, however, that – subject to the application of paragraph (*c*) of the definition – corporations described in paragraph (*b*) that at any particular time have no LRIP may pay eligible dividends without restriction.

Examples

Situation: *A public corporation pays, on December 15, 2006, a $5 eligible dividend to each of its 100,000 Class C shareholders, for an aggregate amount of $500,000. At the time the eligible dividends were paid, the public corporation had a LRIP of nil.*

Result: *The public corporation made no excessive eligible dividend designation in respect of the eligible dividends it paid on December 15, 2006, since the lesser of the aggregate of all eligible dividends paid at that time, $500,000, and the public corporation's LRIP at that time, nil – A in the formula in paragraph (b) of the definition, is nil.*

Situation: *A non-CCPC private corporation pays, on March 15, 2007, a $20,000 eligible dividend to each of its two Class A shareholders, for an aggregate amount of $40,000. At the time the eligible dividends were paid, the non-CCPC private corporation had a LRIP of $18,000.*

Result: *The non-CCPC private corporation made an excessive eligible dividend designation in respect of the eligible dividends it paid on March 15, 2007, since the lesser of the aggregate of all eligible dividends paid at that time, $40,000, and the non-CCPC private corporation's LRIP at that time, $18,000 is $18,000. In respect of each eligible dividend paid, the non-CCPC private corporation made an excessive eligible dividend designation of $9,000 – that proportion of $18,000 that the amount of the eligible dividend paid, $20,000, is of the total of all amounts each of which was an eligible dividend paid by the non-CCPC private corporation at that time, $40,000.*

Paragraph (*c*) of the definition is an anti-avoidance provision. It applies in respect of an eligible dividend paid by a corporation – regardless of whether paragraph (*a*) or (*b*) would otherwise apply – if it is reasonable to consider that the eligible dividend was paid in a transaction, or as part of a series of transactions, one of the main purposes of which was to artificially manipulate the corporation's GRIP or LRIP, as the case may be.

In general terms, it is intended that a corporation be considered to have artificially maintained or increased its GRIP if the transaction or series of transactions produces a GRIP that is unreflective of income retained by it after payment of tax under Part I (whether the tax is paid by the corporation or another corporation) at a rate not less than that which applies to full rate taxable income (as defined in subsection 123.4(1) of the Act). Likewise, it is intended that a corporation generally be considered to have artificially maintained or decreased its LRIP if the transaction or series of transactions produces a LRIP that is unreflective of income retained by it after payment of tax under Part I (whether the tax is paid by the corporation or another corporation) at a rate less than that which applies to full rate taxable income.

If this paragraph applies, the amount of the excessive eligible dividend made by the corporation is equal to the amount of the eligible dividend.

The new definition "excessive eligible dividend designation" in subsection 89(1) applies in respect of taxation years that end after 2005.

"general rate income pool"

The new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act applies in respect of taxable Canadian corporations that are Canadian-controlled private corporations (CCPCs) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or deposit insurance corporations (DICs) (within the meaning assigned by new subsection 89(15); see commentary on that subsection), and is generally relevant for determining the extent to which such corporations can pay eligible dividends in any given taxation year without making an excessive eligible dividend designation .

The general rate income pool (GRIP) of a corporation at the end of a particular taxation year is the positive or negative amount calculated by reference to a formula:

$$A - B$$

In broad terms, A is the corporation's GRIP at the end of the taxation year determined without reference to any specified future tax consequences, such as the carry-back of non-capital losses under paragraph 111(1)(*a*), and B adjusts that amount at the end of the taxation year to the extent that specified future tax consequences for preceding taxation years reduce the corporation's taxable income subject to tax at the general corporate rate in section 123 of the Act. As a result, a CCPC or DIC can have a negative GRIP.

The bulk of the GRIP is contained in the description of A, which itself is the positive or negative amount determined by another formula:

$$C + 0.68(D - E - F) + G + H - I$$

C is the corporation's GRIP at the end of the preceding taxation year, which again as noted above can be a nil or negative amount and at this stage in the formula is unadjusted for eligible dividends paid by the corporation in that preceding taxation year.

The next part of the formula, $0.68(D - E - F)$, is intended to generate an amount equal to the after-tax earnings of the corporation, assuming a notional combined federal-provincial general corporate tax rate of 32%. D is the corporation's taxable income for the taxation year, unless the corporation is a DIC, in which case the amount is nil. (The taxable income of most DICs is already taxed at a preferential rate under subsection 137.1(9). See commentary on new subsection 89(15) of the Act.)

Taxable income in respect of which the corporation has benefited from the small business deduction under subsection 125(1) (including a deduction under that subsection by reason of subsections 137(3) and (4) of the Act) is the E amount. E is subtracted from the D amount. If the corporation is a CCPC, the F amount is the lesser of the corporation's aggregate investment income for the particular taxation year and the corporation's taxable income for the particular taxation year. F is also subtracted from the D amount. In any other case, the amount for F is nil.

G and H are additions to the GRIP generally in respect of amounts received from other corporations. Eligible dividends received by the corporation in the particular taxation year and amounts deductible by the corporation under section 113 in respect of dividends received from a foreign affiliate are included under the G amount.

H includes in the GRIP the total of all amounts determined under new subsections 89(4) to (6) (see commentaries on those subsections). Broadly speaking, these provisions add amounts to a corporation's GRIP following certain corporate changes, such as amalgamations and windings-up, as well as a limited addition in respect of corporate earnings generated before 2006.

I reduces a corporation's GRIP for a particular taxation year by the eligible dividends paid by it in its preceding taxation year, but only to the extent that the corporation did not make excessive eligible dividend designations in respect of the eligible dividends. However, if subsection 89(4) applies to the corporation in the particular taxation year, the amount for I is nil.

The new definition "general rate income pool" in subsection 89(1) applies in respect of taxation years that end after 2005.

"low rate income pool"

The new definition "low rate income pool" in subsection 89(1) of the Act applies in respect of a corporation (referred to in the definition as a non-CCPC) that is neither a Canadian-controlled private corporation (see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7), and new subsection 249(4.1)) nor a deposit insurance corporation (within the meaning assigned by new subsection 89(15); see commentary on that subsection), and is generally relevant for determining the extent to which the non-CCPC can pay eligible dividends in any given taxation year without making an excessive eligible dividend designation (see commentary on the definition "excessive eligible dividend designation" in subsection 89(1)).

The low rate income pool (LRIP) of a corporation at any time in a particular taxation year is the amount determined by reference to a formula:

$$(A + B + C + D + E + F) - (G + H)$$

A is a non-CCPC's LRIP at the end of its preceding taxation year. It is worth noting that, unlike the general rate income pool (see commentary on the new definition "general rate income pool" in subsection 89(1)), the LRIP is computed at any particular time in a taxation year, and therefore the non-CCPC's LRIP at the end of the preceding taxation year is already adjusted to take into account any taxable dividends other than eligible dividends paid, and excessive eligible dividend designations made, by the non-CCPC in the preceding taxation year (see also the discussions below of G and H in formula).

B includes in the LRIP the total of all amounts each of which is an amount deductible under section 112 of the Act in computing the non-CCPC's taxable income for the year in respect of a taxable dividend (other than an eligible dividend) that became payable, in the particular taxation year but before the particular time, to the non-CCPC by a corporation resident in Canada. The B amount will thus typically include dividends paid to a non-CCPC by a CCPC. The link to deductibility under section 112, meanwhile, means among other things that the LRIP of a non-CCPC that is a mortgage investment corporation (MIC) will not be increased by the receipt of such taxable dividends, since the deduction under section 112 is unavailable to MICs pursuant to paragraph 130.1(1)(b) of the Act. (See also the discussion below of G, which contains the corresponding treatment of taxable dividends (other than eligible dividends) paid by MICs.)

C includes in the LRIP the total of all amounts determined under new subsections 89(8) to (10) (see commentaries on those subsections). Broadly speaking, these provisions add amounts to a corporation's LRIP following certain corporate changes, such as amalgamations and windings-up.

D includes in a non-CCPC's LRIP the after-tax amount of its aggregate investment income for its preceding taxation year (assuming a notional tax rate of 20%). Only a non-CCPC that would, but for an election made under new subsection 89(11) of the Act in respect of the definition "Canadian-controlled private corporation", have been a CCPC in its preceding taxation year is required to include an amount in respect of D.

E is relevant only to a non-CCPC that was a credit union in its preceding taxation year and that deducted an amount, from tax payable for that preceding year, under subsection 137(3) of the Act (such amounts are deemed by subsection 137(4) of the Act to be deducted under subsection 125(1)). The after-tax amount (assuming a tax rate of 20%) of any deduction made under subsection 125(1) of the Act by a non-CCPC that was not a CCPC in the preceding taxation year is included in the non-CCPC's LRIP under E.

F is relevant only if the non-CCPC was an investment corporation in its preceding taxation year. F includes in a non-CCPC's LRIP an amount in respect of any deduction made by the non-CCPC in its preceding taxation year under subsection 130(1) of the Act.

G and H reduce a non-CCPC's LRIP. Broadly put, variable G reduces the LRIP by taxable dividends (other than eligible dividends) paid by the non-CCPC in the particular taxation year but before the particular time. As with eligible dividends, taxable dividends paid by the non-CCPC that are capital gains dividends, within the meaning ascribed by subsection 130.1(4) or 131(1) of the Act or that are deductible by the corporation under subsection 130.1(1) of the Act in computing its income for the particular taxation year or for its preceding taxation year do not reduce the non-CCPC's LRIP.

H reduces a non-CCPC's LRIP by excessive eligible dividend designations made by the non-CCPC in respect of an eligible dividend paid by it in the particular taxation year but before the particular time.

The new definition "low rate income pool" subsection 89(1) applies in respect of taxation years that end after 2005.

GRIP addition: becoming a CCPC

ITA
89(4)

New subsection 89(4) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). H in the formula in that definition includes, among other things, an amount determined for a particular taxation year under subsection 89(4) in respect of a corporation to which the definition applies.

Generally, subsection 89(4) applies when a corporation changes status from being a corporation that is neither a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) nor a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) in its preceding taxation year to a corporation that is either a CCPC or a DIC in a particular taxation year. The amount determined under subsection 89(4) in respect of the corporation is included in computing the corporation's GRIP at the end of the particular taxation year.

If subsection 89(4) applies, the amount included is determined by reference to the formula

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the corporation's GRIP would have been at the end of its preceding taxation year had it been either a CCPC or a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's GRIP. A and B include, respectively, the cost amount to the corporation of all of its property and any money of the corporation immediately before the end of its preceding taxation year.

C generally provides that the amount will be increased to the extent that the corporation has unused and unexpired losses at the end of its preceding taxation year.

D to H of the formula reduce the amount that will be included in respect of the corporation's GRIP. D is the total of all amounts each of which is the amount of any debt owing by the corporation, or of any other obligation of the corporation to pay any amount, that was outstanding immediately before the end of its preceding taxation year. E is the paid up capital, immediately before the end of its preceding taxation year, of all the issued and outstanding shares of the capital stock of the corporation, and F is the total of all reserves deducted by the corporation in its preceding taxation year. G and H are, respectively, the capital dividend account, if any, and the low rate income pool of the corporation immediately before the end of its preceding taxation year.

New subsection 89(4) applies to taxation years that end after 2005.

GRIP addition: post-amalgamation

ITA
89(5)

New subsection 89(5) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). H in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(5) in respect of a corporation to which the definition applies.

Generally, subsection 89(5) applies when a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) is formed as a result of an amalgamation to which subsection 87(1) of the Act applies. The total of all amounts determined under subsection 89(5) is included in computing the corporation's GRIP at the end of its first taxation year.

Subsection 89(5) is divided into two paragraphs, and their application to a predecessor depends on whether the predecessor was a CCPC or a DIC in its taxation year that ended immediately before the amalgamation (referred to in the subsection as "its last taxation year"). Paragraph (*a*) applies in respect of a predecessor that was a CCPC or a DIC in its last taxation year, and includes the positive or negative amount determined by the formula A – B. This formula is intended to flow through to the corporation's GRIP at the end of its first taxation year a CCPC or DIC predecessor's GRIP at the end of the predecessor's last taxation year (adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made by the predecessor in that last taxation year).

Paragraph (*b*) applies in respect of a predecessor that was neither a CCPC nor a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the predecessor's GRIP would have been at the end of its last taxation year had it been either a CCPC or a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's GRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the predecessor of a property and any money of the predecessor immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the predecessor has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect the corporation's GRIP. D is the total of all debts owing by the predecessor, or of any other obligation of the predecessor to pay any amount, that was outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the predecessor, and F is the total of all reserves deducted by the predecessor in its last taxation year. G and H are, respectively, the capital dividend account, if any, and the LRIP of the predecessor immediately before the end of its last taxation year.

New subsection 89(5) applies to taxation years that end after 2005.

GRIP addition: post-winding-up

ITA
89(6)

New subsection 89(6) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). H in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(6) in respect of a corporation to which the definition applies.

Generally, subsection 89(6) applies in respect of a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) or a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) that has wound-up a subsidiary in accordance with subsection 88(1) of the Act. The total of all amounts determined under subsection 89(6) is included in computing the parent's GRIP at the end of its taxation year that immediately follows the taxation year of the subsidiary in which it was wound-up (referred to in the subsection as the subsidiary's "last taxation year").

Subsection 89(6) is divided into two paragraphs, and their application to the subsidiary depends on whether it was a CCPC or DIC in its last taxation year. Paragraph (*a*) applies if the subsidiary was a CCPC or a DIC in its last taxation year, and includes the positive or negative amount determined by the formula A – B. This formula is intended to flow through to the parent's GRIP the subsidiary's GRIP at the end of its last taxation year (adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made by the subsidiary in its last taxation year).

Paragraph (*b*) applies if the subsidiary was neither a CCPC nor a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the subsidiary's GRIP would have been at the end of its last taxation year had it been either a CCPC or a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the parent's GRIP under the subsection. A and B include, respectively, the total of all amounts each of which is the cost amount to the subsidiary of a property and any money of the subsidiary immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the subsidiary has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect of the parent's GRIP. D is the total of all debts owing by the subsidiary, including other obligations of the subsidiary to pay any amount, that were outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the subsidiary, and F is the total of all reserves deducted by the subsidiary in its last taxation year. G and H are, respectively, the capital dividend account, if any, and the LRIP of the subsidiary immediately before the end of its last taxation year.

New subsection 89(6) applies to taxation years that end after 2005.

GRIP addition for 2006

ITA
89(7)

New subsection 89(7) of the Act is relevant to the new definition "general rate income pool" (GRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). C in the formula in that definition is the amount of the corporation's GRIP at the end of the preceding taxation year.

Subsection 89(7) applies if a corporation was (or, absent an election under new subsection 89(11), would have been), throughout its first taxation year that includes any part of January 1, 2006, a Canadian-controlled private corporation (see commentary on subsection 89(11)). The subsection deems the corporation's GRIP at the end of the taxation year immediately preceding that first taxation year to be the greater of nil or the amount determined by the formula A – B. In general terms, the formula approximates the after-tax amount (based on a notional combined federal-provincial corporate rate of tax of 37%) of the earnings of the corporation that were subject to general corporate tax rate for taxation years of the corporation that ended after 2000 and before 2006 and that have not been paid by the corporation as taxable dividends during those taxation years. Generally, dividends received by the corporation are not included in this calculation, however an exception is made in respect of dividends received from a connected corporation, or through a chain of connected corporations, in circumstances where the dividend may reasonably be considered to be attributable to income that was subject to tax at the general corporate rate.

It is intended that, if a corporation includes an amount in computing its GRIP by reason of subsection 89(7), the corporation will have a GRIP in respect of which eligible dividends may be paid as of January 1, 2006. Subsection 89(7) is also intended to accommodate elections made under new subsection 89(11) in respect of taxation years that include January 1, 2006 (see commentary on that new subsection), as well as amalgamations that occur, and windings-up that begin on January 1, 2006, and involve Canadian-controlled private corporations.

Subsection 89(7) applies in respect of the first taxation year that includes any part of January 1, 2006.

LRIP addition: ceasing to be a CCPC

ITA
89(8)

New subsection 89(8) of the Act is relevant to the new definition "low rate income pool" (LRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). C in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(8) in respect of a corporation to which the definition applies.

Generally, subsection 89(8) applies when a corporation changes status from having been a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation (DIC) in its preceding taxation year to being a corporation that is neither a CCPC nor a DIC in the particular taxation year. The amount determined under subsection 89(8) in respect of the corporation is included in computing the corporation's LRIP at any time in the particular taxation year.

If subsection 89(8) applies, the amount included is determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the corporation's LRIP would have been at the end of its preceding taxation year had it been neither a CCPC nor a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's LRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the corporation of a property and any money of the corporation immediately before the end of its preceding taxation year.

C generally provides that the amount will be increased to the extent that the corporation has unused and unexpired losses at the end of its preceding taxation year.

D to H of the formula reduce the amount that will be included in respect the corporation's LRIP. D is the total of all debts owing by the corporation, including other obligations of the corporation to pay any amount, that were outstanding immediately before the end of its preceding taxation year. E is the paid up capital, immediately before the end of its preceding taxation year, of all the issued and outstanding shares of the capital stock of the corporation, and F is the total of all reserves deducted by the corporation in its preceding taxation year.

G is the capital dividend account, if any, of the corporation immediately before the end of its preceding taxation year, unless the corporation is a private corporation in the particular taxation year, in which case the amount for G is nil.

H reduces the addition to the corporation's LRIP by the amount determined by the formula I – J, which is the corporation's GRIP at the end of its preceding taxation year, adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made in respect of any eligible dividends paid by the corporation in its preceding taxation year.

New subsection 89(8) applies to taxation years that end after 2005.

LRIP addition: post-amalgamation

ITA
89(9)

New subsection 89(9) of the Act is relevant to the new definition "low rate income pool" (LRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). C in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(9) in respect of a corporation to which the definition applies.

Generally, subsection 89(9) applies when a corporation that is neither a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) nor a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) is formed as a result of an amalgamation to which subsection 87(1) of the Act applies. The total of all amounts determined under subsection 89(9) is included in computing the corporation's LRIP at any time in its first taxation year.

Subsection 89(9) is divided into two paragraphs, and their application to a predecessor depends on whether the predecessor was a CCPC or DIC in its taxation year that ended immediately before the amalgamation (referred to in the subsection as "its last taxation year"). Paragraph (*a*) applies in respect of a predecessor that was neither a CCPC nor a DIC in its last taxation year, and includes the predecessor's LRIP at the end of its last taxation year.

Paragraph (*b*) applies if the predecessor was either a CCPC or a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the predecessor's LRIP would have been at the end of its last taxation year had it been neither a CCPC nor a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the corporation's LRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the predecessor of a property and any money of the predecessor immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the predecessor has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect the corporation's LRIP. D is the total of all debts owing by the predecessor, including other obligations of the predecessor to pay any amount, that were outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the predecessor, and F is the total of all reserves deducted by the predecessor in its last taxation year.

G is the capital dividend account, if any, of the predecessor immediately before the end of its last taxation year, unless the corporation is a private corporation in its first taxation year, in which case the amount for G is nil.

H reduces the addition to the corporation's LRIP by the amount determined by the formula I – J, which is the predecessor's GRIP at the end of its last taxation year, adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made by the predecessor in its last taxation year.

New subsection 89(9) applies to taxation years that end after 2005.

LRIP addition: post-winding-up

ITA
89(10)

New subsection 89(10) of the Act is relevant to the new definition "low rate income pool" (LRIP) in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)). C in the formula in that definition includes, among others, an amount determined for a particular taxation year under subsection 89(10) in respect of a corporation to which the definition applies.

Generally, subsection 89(10) applies in respect of corporation that is neither a Canadian-controlled private corporation (CCPC) (within the meaning assigned by subsection 125(7); see commentaries on the amended definition "Canadian-controlled private corporation" in subsection 125(7) and new subsection 249(4.1)) nor a deposit insurance corporation (DIC) (within the meaning assigned by new subsection 89(15); see commentary on that subsection) that has wound-up a subsidiary. The total of all amounts determined under subsection 89(10) is included in computing the corporation's LRIP at any time in its taxation year that immediately follows the taxation year of the subsidiary in which it was wound-up (referred to in the subsection as the subsidiary's "last taxation year").

Subsection 89(10) is divided into two paragraphs, and their application to the subsidiary depends on whether the subsidiary was a CCPC or DIC in its last taxation year. Paragraph (*a*) applies in respect of a subsidiary that was neither a CCPC nor a DIC in its last taxation year, and includes the subsidiary's LRIP at the end of its last taxation year.

Paragraph (*b*) applies if the subsidiary was either a CCPC or a DIC in its last taxation year, and includes an amount determined by reference to a formula:

$$A + B + C - D - E - F - G - H$$

In broad terms, this formula is intended to determine what the subsidiary's LRIP would have been at the end of its last taxation year had it been neither a CCPC nor a DIC in that taxation year.

A, B, and C of the formula augment the amount that will be included in respect the parent's LRIP. A and B include, respectively, the total of all amounts each of which is the cost amount to the subsidiary of a property and any money of the subsidiary immediately before the end of its last taxation year.

C generally provides that the amount will be increased to the extent that the subsidiary has unused and unexpired losses at the end of its last taxation year.

D to H of the formula grind the amount that will be included in respect of the parent's LRIP. D is the total of all debts owing by the subsidiary, including other obligations of the subsidiary to pay any amount, that were outstanding immediately before the end of its last taxation year. E is the paid up capital, immediately before the end of its last taxation year, of all the issued and outstanding shares of the capital stock of the subsidiary, and F is the total of all reserves deducted by the subsidiary in its last taxation year.

G is the capital dividend account, if any, of the predecessor immediately before the end of its last taxation year, unless the parent is a private corporation in the its taxation year that immediately follows the subsidiary's last taxation year, in which case the amount for G is nil.

H reduces the addition to the parent's LRIP by the amount determined by the formula I – J, which is the subsidiary's GRIP at the end of its last taxation year, adjusted to take into account any eligible dividends paid and any excessive eligible dividend designations made in respect of any eligible dividends paid by the subsidiary in its last taxation year.

New subsection 89(10) applies to taxation years that end after 2005.

Election: non-CCPC

ITA
89(11) to (13)

New subsections 89(11) to (13) of the Act contain new rules involving an election that may be made by a corporation to be treated for certain purposes as not being a CCPC. Those purposes are described in new paragraph (*d*) of the definition "Canadian-controlled private corporation" (CCPC) in subsection 125(7) of the Act (see commentary on the amended definition in subsection 125(7)) . In order to be so treated at any time in or after a particular taxation year, a corporation must file with the Minister an election under subsection 89(11) on or before its filing-due date for the particular taxation year.

An election made under subsection 89(11) may be revoked by the corporation by filing with the Minister, on or before its filing-due date for a particular taxation year, a notice revoking the election made under subsection 89(11), in which case the election will cease to apply to the corporation at the end of the particular taxation year. However, once a corporation has revoked an election, its ability to subsequently elect under subsection 89(11) or revoke an election under subsection 89(12) will be restricted under subsection 89(13).

Note that the election and the revocation of an election provided for under, respectively, subsections 89(11) and (12) will not be prescribed for the purposes of section 600 of the Income Tax Regulations.

New subsections 89(11) to (13) apply to taxation years that end after 2005.

Dividend designation

ITA
89(14)

New subsection 89(14) of the Act is relevant to the new definition "eligible dividend" definition in subsection 89(1) of the Act (see commentary on that definition in subsection 89(1)); that definition in turn is most notably relevant for the purposes of the 45% "gross-up" in amended paragraph 82(1)(*b*) of the Act and the corresponding dividend tax credit of 11/18 in new paragraph 121(*b*) of the Act (see commentaries on subsection 82(1) and section 121).

In order for a taxable dividend to be an eligible dividend it must have been, among other requirements, designated as such by the corporation paying the taxable dividend. A corporation designates a dividend it pays at any time to be an eligible dividend by notifying in writing at that time each person or partnership to whom it pays all or any part of the dividend that the dividend is an eligible dividend.

Note that the designation set out under subsection 89(14) will not be prescribed for the purposes of section 600 of the Income Tax Regulations.

New subsection 89(14) applies to taxation years that end after 2005, except that in respect of a dividend paid before this Act is assented to, a designation under subsection 89(14), will be deemed to have been made in a timely manner if it is made on or before the day that is 90 days after the day on which this Act is assented to.

Interpretation – "deposit insurance corporations"

ITA
89(15)

New subsection 89(15) of the Act contains an interpretive rule that applies for the purposes of the new rules concerning the tax treatment of eligible dividends, most notably for the purposes of the new definitions "general rate income pool" and "low rate income pool" in subsection 89(1) of the Act (see commentaries on those definitions in subsection 89(1)). It clarifies that, for the purpose of those rules, there are to be treated as deposit insurance corporations (DICs) only some of the corporations that are DICs for the purposes of section 137.1 of the Act. The section 137.1 DICs that are not so treated are those incorporated under the Canada Deposit Insurance Corporation Act or deemed by subsection 137.1(5.1) to be a DIC.

New subsection 89(15) applies to taxation years that end after 2005.

Clause 48

Dividend tax credit for eligible dividends

ITA
121

Section 121 of the Act is a key component of the integration rules for dividends received by individuals from taxable Canadian corporations. In broad terms, an amount (often referred to as the "gross-up") equal to 1/4 of a taxable dividend received by an individual shareholder is included in income under existing paragraph 82(1)(*b*). Existing section 121 provides a corresponding deduction from tax payable by the individual (often referred to as the "dividend tax credit") equal to 2/3 of the gross-up.

Section 121 is amended by introducing a new dividend tax credit of 11/18 of the gross-up in respect of eligible dividends (see commentary on the new definition "eligible dividend" in subsection 89(1)). This new dividend tax credit corresponds to the 45% gross-up included in income under amended subsection 82(1) of the Act in respect of eligible dividends (see commentary on subsection 82(1)). In general terms, the new gross-up and dividend tax credit are intended to integrate earnings subject to the general corporate rate in section 123 of the Act.

The existing 2/3 dividend tax credit is preserved in new paragraph 121(*a*), and is computed by reference to the 25% gross-up included in computing income under subparagraph 82(1)(*b*)(i). The new dividend tax credit in respect of eligible dividends is contained in new paragraph 121(*b*), and is computed by reference to the 45% gross-up included in computing income under subparagraph 82(1)(*b*)(ii).

Amended section 121 applies to dividends paid after 2005.

Clause 49

Interpretation – “Canadian-controlled private corporation”

ITA
125(7)

Subsection 125(7) of the Act defines "Canadian-controlled private corporation" (CCPC), among other terms. This definition applies not only to the small business deduction under section 125 but also, through its incorporation by reference into subsection 248(1) of the Act, to the Act as a whole.

The definition is amended by adding a new paragraph. New paragraph (*d*) permits a corporation that would otherwise be a CCPC and that has filed an election as required under new subsection 89(11) (see commentary on that subsection) to be treated for certain purposes as not being a CCPC, most notably for the purposes of the small business deduction in subsection 125(1) of the Act and most of the new rules concerning the tax treatment of eligible dividends (see commentary on the definition “eligible dividend” in subsection 89(1)).

New paragraph (*d*) of the definition applies to the 2006 and subsequent taxation years.

Clause 50

Consequential amendment to paragraph 127.52(1)(*f*)

ITA
127.52(1)(*f*)

Section 127.5 of the Act levies the minimum tax payable by an individual under Part I of the Act for a particular taxation year, and paragraph 127.52(1)(*f*) of the Act is relevant in computing an individual’s minimum tax base for the particular taxation year under subsection 127.52. Under existing paragraph 127.52(1)(*f*), the existing "gross-up" in respect of taxable dividends received from taxable Canadian corporations that is included in income under paragraph 82(1)(*b*) of the Act is excluded in computing the minimum tax base.

Consequential to amendments to subsection 82(1), paragraph 127.52(1)(*f*) is amended so that an individual's minimum tax base is computed without reference to paragraph 82(1)(*b*). As a result, amounts included in income in respect of the existing 25% gross-up for taxable dividends (other than eligible dividends), now provided for in subparagraph 82(1)(*b*)(i), and the new 45% gross-up for eligible dividends, provided for in subparagraph 82(1)(*b*)(ii) (see commentary on amended subsection 82(1)) are excluded from an individual's minimum tax base.

Amended paragraph 127.52(1)(*f*) applies to dividends paid after 2005.

Clause 51

Additional tax on excessive eligible dividend designations

ITA
Part III.1

New Part III.1 of the Act is enacted as a consequence of the introduction of an enhanced dividend "gross-up" and tax credit for "eligible dividends" paid by corporations resident in Canada to their Canadian-resident individual shareholders. Part III.1 applies a tax to a corporation that has made an "excessive eligible dividend designation" as newly defined in subsections 248(1) and 89(1) of the Act (referred to in these notes as an “excessive designation”).

As the definition implies, an excessive designation may be inadvertent, or it may result from an attempt to artificially manipulate a corporation's "general rate income pool" (GRIP) or "low rate income pool" (LRIP) (both of which terms are also defined in subsections 248(1) and 89(1)). The effect of Part III.1 in respect of a particular excessive designation depends on which of these is the case. If the excessive designation arises merely because a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation has as a factual matter in a given taxation year designated as "eligible dividends" a total amount that exceeds its GRIP at the end of the year (both of which terms are also defined in subsection 89(1)), the tax under Part III.1 is equal to 20% of the excessive designation.

The same 20% rate applies if a corporation that is neither a CCPC nor a deposit insurance corporation happens to pay an eligible dividend at a time when it has a positive balance in its "low rate income pool" (LRIP). In effect, the corporation will face a tax equal to 20% of the amount of the dividend that should have been considered to represent LRIP, and thus should not have been an eligible dividend.

In either of these cases the dividend-paying corporation can (subject generally to its shareholders' consent) elect to treat all or part of the excessive designation amount as a separate, ordinary dividend – that is not an eligible dividend. To the extent it does this, the Part III.1 tax does not apply, and the shareholders are considered to have received an ordinary dividend to the extent of the elected amount. This optional recharacterization is generally modeled on that offered under existing Part III of the Act in respect of excessive capital dividends and capital gains dividends.

If, however, the excessive designation falls into paragraph (*c*) of the definition "excessive eligible dividend designation" in subsection 89(1), the tax under Part III.1 is imposed at a rate of 30%, on the entire amount of the dividend in question. Additionally, the election described above is not available, meaning that the corporation cannot unwind the effect of its excessive designation.

Regardless which rate of tax applies under new Part III.1, if a CCPC or a deposit insurance corporation pays an eligible dividend in respect of which it has made an excessive designation to a non-arm's length shareholder, the shareholder is jointly and severally, or solidarily, liable for a proportionate amount of the corporation's tax under the Part in respect of the dividend.

Part III.1 generally applies to taxation years that end after 2005. The only exception is a special accommodation provided for elections under new subsection 185.1(2) of the Act (described below). If a corporation pays a dividend before this legislation is enacted, and the corporation wishes to make that election in respect of the dividend, that election will be treated as having been made in a timely manner if it is made within 30 months after Royal Assent to the legislation.

Tax on excessive eligible dividend designations

ITA
185.1(1)

New subsection 185.1(1) of the Act imposes liability for tax under Part III.1 of the Act. The tax is payable, on or before a corporation's balance-due day for a given taxation year, if the corporation has made an excessive eligible dividend designation (an "excessive designation" in these notes) in respect of an eligible dividend it has paid in the taxation year. The amount of the tax depends on the nature of the excessive designation. If it arises in a circumstance described in paragraph (*a*) or (*b*) of the definition "excessive eligible dividend designation" in subsection 89(1) of the Act, the tax is equal to 20% of the excessive designation. If paragraph (*c*) of that definition applies, the tax is equal to 30% of the excessive designation: the same 20% that applies in other cases, plus an additional 10%.

It should be noted that, where it applies, paragraph (*c*) of the definition treats the entire amount of an eligible dividend as an excessive designation; as a result, the tax imposed by new subsection 185.1(1) is in that case equal to 30% of the full amount of the eligible dividend, not merely of the amount by which the eligible dividend exceeded the relevant "pool" (GRIP or LRIP, as the case may be).

Election

ITA
185.1(2) to (4)

A corporation that would otherwise be subject to tax under Part III.1 of the Act in respect of an excessive designation can, provided certain conditions are met, in effect retroactively undo all or part of the excessive designation. This mechanism is set out in new subsections 185.1(2) to (4) of the Act.

There are three conditions for an election under subsection 185.1(2). First, the excessive designation in question must not be one that is described in paragraph 185.1(1)(*b*) – the election is unavailable where the 30% tax rate applies.

Second, the corporation that made the excessive designation must elect in prescribed manner (i.e., in the manner set out by the Minister of National Revenue) in respect of the excessive designation, and that election must be made on or before the day that is 90 days after the mailing of the notice of assessment that deals with the Part III.1 tax that the corporation would otherwise have to pay. This timing is important: there is no possibility of a late election under Part III.1.

Third, as set out in subsection 185.1(3), the election is valid only with the concurrence of certain shareholders. If the election is made within 30 months of the payment of the dividend that was the subject of the excessive designation (the "original dividend"), those shareholders whose concurrence is needed are all those who received or were entitled to receive the original dividend and whose addresses the corporation knew. If the election is made later than that, the concurrence of all of the shareholders who received or were entitled to receive the original dividend is required, regardless of whether the corporation knew their addresses. In this second case (an election more than 30 months after the payment of the original dividend), subsections 152(4) to (5) will not prevent whatever assessment of tax, interest and penalties payable by those shareholders may be needed to take account of the corporation's election.

Subsection 185.1(4) provides an exception to the requirement for shareholder concurrence. If all of the affected shareholders are persons all of whose taxable income is exempt from tax under Part I of the Act, their consent is not necessary. However, the election must in this case be made within 30 months after the payment of the original dividend.

The general effect of a valid election under subsection 185.1(2) is that the original dividend is treated as having been an eligible dividend in a lesser amount, and the corporation is treated as having paid, immediately before the original dividend, a taxable dividend that was not an eligible dividend. The corporation making the election can, subject to its shareholders' concurrence as described above, decide how much (if any) of the original eligible dividend it wishes to have still treated as an eligible dividend. The holders of the shares on which the corporation paid the original dividend are treated as having received, instead of the original dividend, their pro-rata portion of the dividends (or dividend, if the corporation chooses not to leave any part of the original dividend as an eligible dividend) the corporation is now treated as having paid.

Rules applicable to Part III.1

ITA
185.2

New section 185.2 of the Act sets out several rules that govern the operation of new Part III.1.

Subsection 185.2(1) provides that every corporation resident in Canada that pays a taxable dividend (other than a capital gains dividend) in a taxation year must file a return for the year under Part III.1. The return must be in prescribed form, it must include an estimate of the corporation's tax payable under the Part for the year, and it must be filed no later than the corporation's filing-due date for the year.

Subsection 185.2(2) incorporates into Part III.1 various provisions of the Act dealing with returns, assessments, payments, appeals and other matters, with such modifications as the circumstances require.

If a Canadian-controlled private corporation or a deposit insurance corporation pays an eligible dividend to a non-arm's length shareholder, and makes an excessive designation in respect of the eligible dividend, subsection 185.2(3) provides that the shareholder is jointly and severally, or solidarily, liable with the corporation for a proportionate amount of the corporation's tax under Part III.1. The shareholder's proportion of the corporation's tax is for this purpose equal to the proportion of the eligible dividend that the shareholder received.

Subsection 185.2(4) provides that the Minister may assess a person in respect of an amount payable under subsection 185.2(3) at any time after the last day on which the corporation can elect under subsection 185.2(2) in respect of the excessive designation that gives rise to the amount payable. Such an assessment will use the provisions of Division I of Part I of the Act, including those relating to interest payable, with any required modifications.

Subsection 185.2(5) sets out rules that determine how a payment on account of a liability under subsection 185.2(3) in respect of a particular excessive designation is to be applied to the liability. If it is a shareholder who makes the payment, the payment will discharge the liability to the extent of the payment. If it is the corporation that makes the payment, the payment discharges a proportionate amount of the liabilities of all of the shareholders who received the eligible dividend in question.

Clause 52

Interpretation

ITA
248

Section 248 of the Act defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

Definitions

ITA
248(1)

"aggregate investment income"

Subsection 248(1) is amended to provide that the term "aggregate investment income" has the meaning assigned in subsection 129(4) of the Act for all purposes of the Act.

"eligible dividend"

Subsection 248(1) is amended to provide that the term "eligible dividend" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

"excessive eligible dividend designation"

Subsection 248(1) is amended to provide that the term "excessive eligible dividend designation" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

"general rate income pool"

Subsection 248(1) is amended to provide that the term "general rate income pool" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

"low rate income pool"

Subsection 248(1) is amended to provide that the term "low rate income pool" has the meaning assigned in subsection 89(1) of the Act for all purposes of the Act.

These new definitions in subsection 248(1) apply to taxation years that end after 2005.

Clause 53

Deemed year-end on status change

ITA
249(4.1)

New subsection 249(4.1) of the Act introduces a new deemed taxation year-end rule. In general terms, this rule applies if at any time a corporation becomes or ceases to be a Canadian-controlled private corporation (CCPC) (within the meaning of the amended definition; see commentary on the definition "Canadian-controlled private corporation" in subsection 125(7) of the Act) otherwise than by way of an acquisition of control to which subsection 249(4) of the Act applies. A corporation to which subsection 249(4.1) applies is treated as having a taxation year-end immediately before the time it becomes or ceases a CCPC.

This new rule is particularly relevant for the purposes of the small business deduction in subsection 125(1) of the Act. Subsection 125(1) provides the basic rules for the calculation of a CCPC's small business deduction, an annual tax credit that is calculated as 16% of the least of certain amounts. Under the existing rules, a corporation must be a CCPC throughout any particular taxation year in order to be eligible to claim the small business deduction. One effect of the new deemed year-end rule is that this requirement will in all cases be met where a corporation is a CCPC at any time in a particular taxation year, since under this new rule corporations can no longer be a CCPC for only part of a taxation year.

The new deemed year-end rule is also of particular relevance to the tax treatment of eligible dividends, including new subsections 89(4) and (8) of the Act that apply to include an amount in a corporation's general rate income pool or low rate income pool when the corporation becomes or ceases to be a CCPC (see commentary on the new definitions "eligible dividend", "general rate income pool", and "low rate income pool" in subsection 89(1)).

New subsection 249(4.1) applies to taxation years that end after 2005.

Clause 54

Deemed eligible dividend

ITA
260(1.1)

Under a securities lending arrangement, the borrower is obligated to compensate the lender for amounts, such as dividends, paid by the issuer of the security during the lending period. For the purpose of the Act, subsection 260(5) deems dividend compensation payments received by a lender to be taxable dividends.

Consequential to the introduction of the new "eligible dividend" definition in subsection 89(1), new subsection 260(1.1) is added. The new subsection contains the conditions under which a dividend compensation payment is deemed by subsection 260(5) to be an eligible dividend as well as a taxable dividend.

For this subsection to apply, and thus for the dividend to be deemed an eligible dividend :

- the lender must be resident in Canada;
- the lender must have received a dividend compensation payment that is deemed to be a taxable dividend; and
- the original dividend must be an eligible dividend or be paid in circumstances described below.

An otherwise non-eligible dividend is considered to have met the last condition when the original dividend was not designated as an eligible dividend by the issuing corporation solely because it was paid to a non-resident shareholder and it is reasonable to conclude that the issuing corporation would, if the shareholder were resident in Canada, have designated the dividend to be an eligible dividend.

This new subsection applies to dividend compensation payments in respect of eligible dividends paid after 2005. Special transitional rules will ensure that with the anticipated replacement, in another income tax amendment Bill, of subsection 260(5) by new subsections 260(5) and (5.1), the reference to subsection 260(5) in this subsection will be changed to subsection 260(5.1).

Deemed dividend

ITA
260(5)

Subsection 260(5) deems dividend compensation payments received by the lender under a securities lending arrangement to be taxable dividends for the purpose of the Act.

Consequential to the introduction of the new "eligible dividend" definition in subsection 89(1), this subsection is amended to deem, for the purpose of the Act, a dividend compensation payment to be an eligible dividend as well as a taxable dividend, if the conditions described in the new subsection 260(1.1) are present.

This amendment applies to dividend compensation payments in respect of eligible dividends paid after 2005.

This consequential amendment to subsection 260(5) is expected to be a transitional measure only, since it is anticipated that subsection 260(5) will be replaced by new subsections 260(5) and (5.1) in another income tax amendment Bill.

Part 3

Excise Act, 2001 - Duty Relief for 100% Canadian Wine

Clause 55

Information on container

EA, 2001
87(a.1)

Section 87 currently requires prescribed information to be displayed on alcohol containers (*i.e.* bottles) immediately after they have been filled except for wine containers that are entered into an excise warehouse. This exception exists to prevent damage to labels during the aging process. Because 100% Canadian wine will be exempt from duty and will not be stored in an excise warehouse, the current provision would not allow for unlabelled bottle aging of 100% Canadian wine.

The section is amended to allow deferral of labelling for 100% Canadian wine aged in a bottle. For those products, the prescribed information must be displayed or affixed before the wine is removed from the licensee's premises, consumed or made available for sale on the premises.

This amendment was not previously announced. It is deemed to have come into force on July 1, 2006.

Clause 56

Bulk wine - relief for 100% Canadian wine

EA, 2001
134(3)

Subsection 134(3) currently provides that duty does not apply to bulk wine produced by an individual for their personal consumption. This subsection is amended to provide that duty will also not apply to bulk wine produced in Canada and composed wholly of agricultural or plant product grown in Canada that is taken for use.

This amendment applies to wine taken for use after June 2006.

Clause 57

Packaged wine - relief for 100% Canadian wine

EA, 2001
135(2)(*a*)

Subsection 135(2) currently provides that duty is not imposed on wine that is produced and packaged by an individual for their own use, or on wine produced and packaged by a wine licensee if the sales of wine by the licensee did not exceed $50,000 in the previous year.

This subsection is amended to provide that duty will also not apply to wine that is produced and packaged in Canada and composed wholly of agricultural or plant product grown in Canada.

This amendment applies to wine packaged after June 2006.

Excise Act - Duty Relief for Canadian Beer

Clause 58

Definition - person

EA
2

The term "person" is used to refer to governments, individuals and all forms of organizations. This definition is added for clarification and is consistent with the definition of "person" in other federal taxing statutes.

This amendment is deemed to have come into force on July 1, 2006.

Clause 59

Related and associated persons

EA
2.2 to 2.4

New rules with respect to related and associated persons are introduced for the purposes of determining eligibility for the special rates of duty on beer and malt liquor imposed under new section 170.1 of the Act. The new reduced rates are set out under the new Part II.1 of the schedule to the Act.

Section 2.2 - Related persons

This section provides that persons are generally related to each other for the purposes of the *Excise Act* if, at a particular time, they are considered to be related persons pursuant to subsections 251(2) to (6) of the *Income Tax Act*.

Section 2.3 - Associated persons

Subsection (1) provides that a particular corporation is associated with another corporation for the purposes of the *Excise Act* if they are considered to be associated pursuant to subsections 256(1) to (6) of the *Income Tax Act*.

Subsection (2) provides that a person (other than a corporation) is associated with a particular corporation if that person or a group of associated persons of which the person is a member controls the corporation.

Subsection (3) sets out the circumstances in which a person will be treated as being associated with a partnership and with a trust.

Subsection (4) states that a person is associated with another person if both persons are associated with a third person.

Section 2.4 - Exception

Section 2.4 provides that incorporated brewers who would otherwise be considered related because they are controlled by individuals connected by blood relationship, marriage or common-law partnership or adoption are deemed not to be related for the purposes of section 170.1 if it is established that they deal with each other at arm's length.

Sections 2.2 and 2.3 were previously announced; only section 2.4 was not. These amendments are deemed to have come into force on July 1, 2006.

Clause 60

Duties

EA
170(1)

Subsection 170(1) currently provides that duty is imposed on beer and malt liquor at the rates set out in the schedule. This subsection is amended to refer to the rates of duty set out in Part II of the schedule. This amendment is consequential to the addition of new Part II.1 of the schedule, which sets out the rates of duty on beer and malt liquor under new section 170.1.

This amendment is deemed to have come into force on July 1, 2006.

Clause 61

Reduced rates - Canadian beer

EA
170.1

New section 170.1 provides for reduced rates of duty on the first 75,000 hectolitres of Canadian-produced and packaged beer and malt liquor. It also sets out rules determining how the reduced rates will apply to various production and packaging arrangements and changes in business structures.

Subsection (1) imposes duty on the first 75,000 hectolitres of beer and malt liquor produced in Canada per year by a licensed brewer and any related or associated person at the rates set out in the new Part II.1 of the schedule to the Act.

Subsection (2) requires, where beer or malt liquor described in subsection (1) is packaged by a brewer other than the brewer referred to in that subsection, that duty be imposed at the rates that applied to that beer or malt liquor under subsection (1).

Subsection (3) provides that beer or malt liquor that is exported or deemed to be exported, or containing not more than 0.5 % absolute ethyl alcohol by volume, will not be taken into account in determining the first 75,000 hectolitres of beer and malt liquor eligible for the reduced rates of duty set out in new Part II.1 of the schedule.

Subsection (4) sets out rules regarding the contract production of beer or malt liquor. For such beer or malt liquor, the quantity produced shall be considered to have been produced by the brewer who has produced the greater volume of beer and malt liquor during the year up to that time, and duty shall be imposed at the rate that applies to that brewer.

Subsection (5) provides that where there is a family of related or associated brewers, each brewer must file an election in a form and manner satisfactory to the Minster that allocates the 75,000 hectolitre quantity among the brewers. The election must be filed no later than the filing due date of the first return in which the brewer reports duties that are imposed, levied and collected under subsection (1).

Subsection (6) sets out rules regarding a brewer formed by a business combination such as an amalgamation or merger. In such circumstances, the aggregate production of the new and predecessor brewers for that year is used for the purposes of applying subsection (1). The new brewer must determine the amount of duty that would have been imposed, levied and collected on the aggregate production volume, and is liable for (and must report and pay) any difference between the amount that would have been imposed and the amounts actually paid by the predecessor brewers within 60 days of the business combination.

These amendments are deemed to have come into force on July 1, 2006, except that, for 2006, every reference to "75,000" in new section 170.1 shall be read as a reference to "37,500". This means that for 2006 only the first 37,500 hectolitres of beer and malt liquor produced in Canada by a licensed brewer after July 1, 2006 will qualify for the duty rate imposed under new section 170.1.

Clause 62

List of duty rate provisions

EA
Schedule

The schedule sets out the rates of duty imposed on products under the Act. The schedule is amended by adding a reference to section 170.1, the provision that provides for the new reduced rates of duty on beer and malt liquor, to the list of provisions for which rates of duty are set out in the schedule.

This amendment was not previously announced. It is deemed to have come into force on July 1, 2006.

Clause 63

Duty on Canadian beer

EA
Schedule, Part II.1

New Part II.1 of the schedule sets out the rates of duty on the first 75,000 hectolitres of beer and malt liquor produced in Canada per year by a licensed brewer under new section 170.1 of the Act. The rates of duty vary based on the production volume of the licensed brewer. The rates also vary depending on the absolute ethyl alcohol volume of the beer or malt liquor being produced.

This amendment is deemed to have come into force on July 1, 2006, except that, for 2006, the reference to "35,000" in section 4 of Part II.1 of the schedule to the Act shall be read as a reference to "22,500" and section 5 of that schedule does not apply. This means that for 2006 only the first 37,500 hectolitres of beer and malt liquor produced in Canada by a licensed brewer after July 1, 2006 will qualify for the reduced rates.